

THE STRATEGIC IMPLICATIONS OF CHINESE COMPANIES GOING GLOBAL

BY

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The Strategic Implications of Chinese Companies Going Global

by

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China's overseas direct investment (ODI) has become one of the biggest business stories of the 21st century. In a relatively short time span, China has become the number one overseas investor amongst developing countries as well as the world's sixth largest overseas investor overall with U.S. \$150 billion invested in foreign markets. Aside from commercial imperatives, this ever-increasing business presence in foreign markets also carries with it foreign policy and security implications. China's soft and hard power potential has been significantly augmented with its phenomenal increase in Chinese commercial clout. This research project exams the actual and potential role of Chinese companies' overseas expansion in Beijing's global foreign and security policy. Particular emphasis will be on European perspectives of the national security implications of China's growing power with respect to its overseas business activities. This topic is also of obvious strategic relevance to the United States as Washington's and Beijing's interests abroad may not always coincide. Thus, Beijing's application of both soft and hard power is of strategic significance to the U.S. as well as its friends and allies.

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Introduction– the Historical Context

December 18, 2008 marked the thirtieth anniversary of the beginning of China's economic reforms which have propelled the country to the epicenter of the global economy after an absence of several centuries. On that date thirty years prior, the 11th Central Committee of the Chinese Communist Party voted to enact the significant economic reforms argued for by Deng Xiaoping. Chinese President Hu Jintao referred to that decision as “a great awakening of the Communist Party.”¹ Deng recognized after the chaos of the Cultural Revolution that if China was to re-establish its economy, build its national power, and return to its rightful place in the sun, then major reforms were required. He stated that China should follow a strategy of “opening to the outside world.”² Deng advocated that through reform and opening up, China would gain access to international capital, management skills, technology, and markets. These were the first steps which, thirty years later, led to China surpassing Germany to become the world's number one exporter, surpassing Japan to become the world's second largest economy overall, and becoming the world's largest consumer of energy ahead of the United States.

During the first two decades of China's economic opening, most of the focus has been on its tremendous economic growth, its massive attraction of foreign direct investment (FDI), its huge trade surplus with the West, and the emergence of a large middle class. China's economy has grown by a factor of 7 in the past 20 years, faster than the U.S. and Japan grew during their early stages of economic development. It took Japan 25 years to grow 6 times during the period 1960-1985 while the U.S. needed over 60 years to grow 3.5 times from 1870 to 1930. Moreover, China's GDP growth is projected to continue at annual growth rates of at least 7 percent through the next decade and beyond.

Yet, a relatively new phenomenon has taken center stage in the last decade, particularly in the past five years. Namely, China's overseas direct investment (ODI) has become one of the biggest economic stories of the 21st century. In a relatively short time span, China has become the number one overseas investor amongst developing countries as well as the world's sixth largest overseas investor overall with U.S. \$150 billion invested in foreign markets.³ This marks

¹ Shi Jiangtao, “Hu Hails Reforms, says Much More Still to Do,” *China Daily*, December 19, 2008, 1.

² Deng Xiaoping, “Why China has Opened Its Doors,” *Foreign Broadcast Information Service, Daily Report: China*, February 12, 1980, LI-5.

³ Peter Wood and Kerry Brown, “China ODI: Buying into the Global Economy,” *XRG C-ODI Report*, October 2009, 5.

a development of strategic significance with implications that go beyond simple economics. However, China's ODI has been paltry by global standards. In 2004, China ranked only 28th in terms of ODI in the world.⁴ In the years 2003-2008, the annual growth rate in Chinese ODI was 60 percent. More interesting perhaps is that during the height of the global financial crisis in 2008 while worldwide ODI contracted by approximately 20 percent, Chinese ODI doubled.⁵

This remarkable strategic emphasis on ODI was, similar to Deng's initiative, a top-down decision made in Beijing at the national level. In the mid 1990s, the going out strategy known in Mandarin as *zou chu qu* was inaugurated by the State Economic and Trade Commission by selecting 120 "national champions" to go abroad as the spearhead of Chinese business engagement abroad.⁶ In 1997, the 15th Congress of the Chinese Communist Party (CCP) encouraged State Owned Enterprises (SOEs) to enter the competitive world market by investing abroad. The then-President Jiang Zemin communicated the government's intent to "establish highly competitive large enterprise groups with trans-regional, inter-trade, cross ownership and transnational operations" in order to "encourage Chinese investors to invest abroad in areas that can bring China's competitive advantage into play so as to make better use of both Chinese and foreign markets and resources."⁷ In a related move, Jiang advised SOEs to go overseas in search of natural resources. This push from the top resulted in Chinese trade with the resource abundant regions of Southeast Asia, Latin America, and Africa growing by an amazing 600 percent during the period 2001-2007.⁸

In 2000, the "Go Global" policy was officially formulated by Premier Zhu Rongji in his annual policy address during which he encouraged Chinese companies to invest abroad. This was in conjunction with China's pending accession to the World Trade Organization (WTO). Zhu envisioned "Go Global" as being a platform for Chinese firms to become more competitive in the world economy. WTO integration was thus critical for China. Although it meant more foreign competition for Chinese companies in their own domestic market, it also provided Chinese companies with more and more access to foreign human capital, best management

⁴ "World Investment Report," United Nations Conference on Trade and Development (UNCTAD), 2005.

⁵ Yun Schueller-Zhou, Margot Schueller, and Magnus Brod, "Chinas Going Global – Finanzmarktkrise bietet Chancen fuer chinesische Investoren im Ausland," *GIGA Focus*, August 2010, 2.

⁶ David Zweig, "China and the World Economy: The Rise of a New Trading Nation" (paper presented at the World International Studies Association, Ljubljana, Slovenia, July 24, 2008) .

⁷ Jiang Zemin, report delivered at the 15th National Congress of the Communist Party of China on September 12, 1997.

⁸ Elizabeth Economy, "The Game Changer," *Foreign Affairs* 89, no. 6 (November-December 2010): 145.

practices, and top technologies from the foreign investors, and competitors, now able to operate in China.

The “Go Global” policy was written into China’s overarching 10th Five Year Plan (2001-2006) as one of the key areas necessary for China’s path to globalization. As Andrew Leung, an authority on China, clearly stated, “going global is very much a national strategy.”⁹ The policy’s objective was to set the stage for certain Chinese companies to compete with the best foreign companies to break through to the ranks of the global Fortune 500. In fact, whereas there were only two Chinese companies in the ranks of the Fortune 500 in 1995, this figure had increased to 22 by 2007. Just as Japan in the 1980s and South Korea in the 1990s, the first decade of the 20th century has witnessed the transformation of Chinese companies from labor-intensive to high value added operations which have added to their desire to go abroad for a myriad of reasons.

China’s tremendous economic growth has been both swift and sustained and has been described as “the most dynamic burst of wealth creation in human history.”¹⁰ It represents a return to the pre-Columbian world order in which China was the center of the global economic system. It is true that much of this growth is based on an export driven economic strategy. However, recent years have witnessed a distinct augmentation to this strategy by greater outward-bound foreign direct investment (FDI) with a particular focus on mergers and acquisitions (M&A) of foreign commercial entities by Chinese companies.

Sound macroeconomic theory supports this vector of growth. China cannot rely exclusively on exports for the type of growth it has seen over the past 30 years. By going global, Chinese companies move past the trade and tariff restrictions of other economies while breaking into new markets with all of the benefits that this entails including access to new technologies, natural resources, and human capital. Plus, the global financial tsunami of 2008 coupled with China’s incredibly large U.S. dollar reserves have allowed Chinese firms to purchase foreign assets quite aggressively and at relatively discounted prices. This has increasingly attracted foreign attention and commentary not all of which has been complementary.

⁹ *BBC World*, December 29, 2007.

¹⁰ “China’s Growing Pains,” *The Economist*, August 19, 2004.

A corollary to its return to the world's economic stage is China's return to the forefront of the geopolitical stage as well. The expansion of the gross national product (GNP) has remained a main component of China's strategy to increase its comprehensive power and influence in international affairs since Deng's reforms of the late 1970s. An increase in its economic prowess is naturally accompanied by an increase in China's overall national power. Yet, China consistently and forcefully rejects any intention to ever use its power and influence aggressively as it refutes having any territorial ambitions in its pronouncement of its peaceful rise in the world.¹¹ However, it is uncontested that China's ODI adds to its political capital and influence, both directly and indirectly, across the globe. It is significant to note that Chinese firms often invest in what the West would characterize as pariah states such as Burma, Iran, Sudan, and Zimbabwe. The Chinese based companies are able, with government support, to make business and commercial decisions that Western democracies would view as politically untenable and morally unsustainable. This affords Chinese companies much greater flexibility and agility which translates into clear first-mover advantages in certain markets.

It is reasonable to correlate China's economic policies with its foreign policies although one must be vigilant about over dramatizing this correlation. *The Economist* famously referred to "a ravenous dragon" in global pursuit of energy and other natural resources to fuel domestic power plants and factories.¹² Due to its massive need for energy to support economic growth coupled with its huge population, China inevitably will fall short on a per capita basis in its demand for natural resources. Thus, a continuous search for sources of energy overseas has led to energy security becoming one of China's most pressing foreign policy objectives. Moreover, a *Foreign Affairs* article stated that "an unprecedented need for resources is now driving China's foreign policy."¹³ While somewhat overstated, there is an obvious connection. Foreign policy decisions are certainly illustrative of enhancing China's national power and capabilities through economic growth.¹⁴

One of the primary sources of CCP legitimacy is sustained economic growth. China's continued economic growth is predicated on a reliably consistent supply of energy and raw

¹¹ Zeng Bijian, "China's Peaceful Rise," *Foreign Affairs* 84, no. 5, (September-October 2005): 18-24.

¹² "A Ravenous Dragon," *The Economist*, March 15, 2008.

¹³ David Zweig and Bi Jianhai, "China's Global Hunt for Energy," *Foreign Affairs* 84, no. 5, (September-October 2005): 25.

¹⁴ Michael Swaine and Ashley Tellis, *Interpreting China's Grand Strategy: Past, Present, and Future* (Santa Monica: RAND, 2000), 97-98.

materials. If this supply is not assured and Chinese economic growth is impaired this could, by extension, challenge the rule of the CCP by calling into question its legitimacy as well as, in a worst case scenario, causing domestic uncertainty and upheaval threatening the all important harmonious society that the CCP's leaders espouse. Those familiar with Chinese history will remember that many a dynasty had fallen to due to such tumult. The CCP itself is intimately aware that they are at the same risk as their dynastic predecessors.

This paper seeks to outline China's economic strategy of going global with its geopolitical implications for national security in political, economic, and diplomatic terms for the United States and other countries. Chapter 1 will focus on the Chinese decision to go global. The paper will address this by first examining the macroeconomic theory behind the Chinese leadership's decision to support global commercial activities, but will also look at political imperatives. In Chapter 2, the key justifications from various perspectives and constituencies will be presented to illuminate the far-reaching decision to go global. Chapter 2 will identify the role of commercial and business entities in Chinese foreign policy. Chapter 3 will go into greater detail in order to explain the commercial and economic reasons while China is so active overseas. This is primarily based on access to resources, markets, technologies, and human capital including intellectual property. Chapter 4 will specify what key industrial sectors are of particular interest to Chinese companies abroad. The chapter will also include profiles of significant Chinese commercial players overseas and the sectors in which their activities are focused. Chapter 5 will examine the soft power implications of Chinese companies going global. Chapter 6 will look at the hard power implications. Chapter 7 will gauge regional reactions to Chinese commercial activities in their geographic areas by evaluating their presence in Africa, Asia, Europe, and the Americas. Chapter 8 will assess the implications for the United States of Chinese companies going global as well as provide some policy recommendations to address and mitigate those implications. Lastly, Chapter 9 will provide a concluding analysis using the framework of the elements of national power as defined by the U.S., namely diplomatic, informational, military, and economic aspects.

Chapter 1 – Beijing’s Decision to “Go Global”

Macroeconomic theory

Long before “globalization” became a household term of reference, the benefits of China’s growing participation in the world economy became readily apparent. China’s economic priorities have shifted significantly over the past 30 years. From a primarily export-driven economy to one in which ODI has an ever increasing role is based on sound macroeconomic logic. The natural limits of international trade will ultimately constrain a purely export-based economy. Chinese enterprises can garner commercial benefits by moving their operations, in various forms and ways, overseas in order to negate the impact of trade and tariff barriers. Chinese business globalization allows for new market entry, access to more developed economies provides potentially high profit margins and a move up the value chain. As previously stated, solid macroeconomic reasoning is also behind ODI for acquiring technological know-how and other knowledge-based assets.

Economists have debated whether China’s path was unique or whether it, like many other developing countries, followed Dunning’s investment development path (IDP) theory.¹⁵ The IDP theory has been widely applied to explain ODI outflows from various countries throughout the world based on the individual state’s level of economic development. Simply put, IDP theory associates ODI levels dependent on per capita GDP. Although in 1996 and again in 2001, Dunning and his colleagues refined the original IDP theory so that it also accounted for human capital, types of products and types of industries.

China’s uniquely gradualist approach to economic reforms produced a massive increase in foreign direct investment in China, exports to other markets, and GDP per capita. In fact, GDP per capita quadrupled between the years 1979 and 2002. This has certainly led to an increased domestic investment in human capital in terms of education and training. Furthermore, such significant increases in per capita GDP has allowed for diversification in products, industries, and markets. These factors demonstrate the relevance of the refinements made in

¹⁵ Xiaohui Liu, Trevor Buck, and Chang Shu, “Chinese Economic Development, the Next Stage: Outward FDI?” *International Business Review* 14, (2005), 98.

Dunning's original IDP theory. It is now convincingly argued that this indirectly and directly led to increases in Chinese ODI.

Dunning's IDP hypothesis was derived from "OLI" theory. Multinational enterprises (MNEs) possess various advantages based on ownership (O) of specific technologies or other knowledge as well as market power obtained in their own home countries. Host countries abroad potentially offer MNEs some localization (L) advantages. Between the MNE and the host country's economy, some internalization (I) advantages could develop. Eventually, L advantages can turn into O advantages in host countries that were initially regarded as targets for inward ODI. Then, the O advantages become the basis for generating ODI from the original host country which then seeks L advantages elsewhere in overseas markets. This can be clearly seen in the Chinese model of economic development. This incremental cycle of a host of FDI then becoming an ODI generator is usually first seen in neighboring markets, either geographically, culturally, or developmentally near, before spreading to more varied locations.

Since the mid 1980s, Chinese ODI reflected an ever increasing integration with the regional and global economy. China's growing economic strength, particularly when viewed in the context of foreign exchange reserves, has allowed for a rapid rise in ODI from China to overseas countries.

The Political-Economic Link in China

Internationally, China's global status depends, in part, on its membership in key international organizations such as the World Trade Organization (WTO) and other economic bodies. The internal Chinese debate on whether to undertake the effort to gain such memberships pitted those in favor of greater integration into the world economy against isolationist tendencies concerned about the dangers of too much foreign influence. Greater integration into the world economy was clearly seen as a prerequisite for sustained growth of the Chinese economy. Thus, two parallel dangers emerged for the Chinese government and for the CCP. If the government did not decide to wholeheartedly embrace the global economy, along with its threats of increased exposure to Western democratic values, then it risked lagging behind economically. Continued economic stagnation carried with it real social costs and potential political costs. Chinese history is fraught with economic problems leading to social and political

crises. Yet if the government did decide to pursue economic globalization and international interdependence, then there would be a risk of increased exposure to foreign political and cultural influences. This worried some within the CCP that social mores and a diversification of political thought could pollute China and put at risk the Party's monopoly on political power.

With the CCP's first priority of maintaining its monopoly on power, this debate was indeed serious and fraught with risks. Thus, China's pursuit of economic self-interest on the international stage has been executed gradually, on a case-by-case basis with the objective of maximum benefit at minimum cost and risk.¹⁶ Economic opening and involvement of Chinese ODI was viewed as a double-edged sword for both political and economic reasons. This impacted the role of Chinese ODI in the country's economic evolution as well as the government's gradualist decision-making process involving how to further ODI while mitigating its risks.

Overview of the Chinese Government Decision

Almost concurrent with the decision to open China to market economics, albeit on a limited basis, was a decision to begin the process of China's outward foreign investment. China's leaders recognized that integrating into the global economy was vital to economic growth. Although there was some acknowledgement that ODI was an important factor in this process of integration, there was still a general trepidation towards entering foreign markets. The central government was concerned about excessive capital outflows, foreign exchange restraints, a perception of Chinese inadequacy in operating effectively overseas, and a potential loss of control of state assets. Thus, a cautious approach towards ODI was initially adopted by the central government. ODI in the early years was miniscule and inconsequential in global economic terms. In 1979, Chinese ODI amounted to only 0.8 million renminbi.¹⁷ However, it represented the beginning of a process that at its apex reached US\$73 billion in 2008.¹⁸

¹⁶ Philip Andrews-Speed and Sergei Vinogradov, "China's Involvement in Central Asian Petroleum," *Asian Review* XL, no. 2 (March/April 2000): 379.

¹⁷ Kevin Cai, "Outward Foreign Direct Investment: A Novel Dimension of China's Integration into the Regional and Global Economy," *The China Quarterly*, no.160 (1999): 859.

¹⁸ "FACTBOX: China's outbound M&A in 2009 and the past decade," Thomson Reuters, January 20, 2010, <http://in.reuters.com>.

The massive growth in Chinese ODI was a result of an evolutionary process entailing almost 30 years. The central government guided this process from the onset. The development of the Chinese government's ODI policies has been characterized as having five stages.¹⁹

- Stage 1 (1979-1983): The State Council was the only approval authority for ODI and approval was on a case-by-case basis. Only state-owned entities were authorized to invest abroad. There were no promulgated regulations on ODI.
- Stage 2 (1984-1992): Non-state companies were allowed to request approval for ODI. The first standardized regulations were promulgated. The then-named Ministry of Foreign Trade and Economic Cooperation (MOFTEC), precursor to the current Ministry of Commerce (MOFCOM) in May 1984 enacted the *Notice about Principles and the Scope of Authority for Examination and Approval of Establishing Non-Trading Enterprises in Foreign Countries, Hong Kong, and Macao*. In July 1985, MOFTEC implemented the *Interim Regulations on the Administrative Measures and Procedures of Examination and Approval of Establishing Non-Trading Enterprises Abroad*.
- Stage 3 (1993-1998): As a result of significant ODI losses in the Hong Kong real estate and stock markets, stricter measures for monitoring and controlling ODI were enacted. The purpose was to formalize the manner in which Chinese capital flowed overseas in order to ensure that the capital is properly invested. The State Planning Commission and State Administration of Foreign Exchange Control were charged with reviewing and assessing ODI proposals of over U.S.\$1 million. MOFTEC still had final approval authority and enacted the *Regulations on the Administration of Overseas Enterprises* in 1993 and the *Measures for the Administration of Overseas Trading Companies and their Representative Offices* in 1997.
- Stage 4 (1999-2002): This marked a major shift in encouraging all types of Chinese enterprises to go abroad. The State Council began to offer incentives such as tax rebates, foreign exchange assistance, and other financial support to Chinese companies to encourage them to go global. The government published *Some Suggestions on Encouraging*

¹⁹ Kenny Zhang, "Going Global: The Why, When, Where, and How of Chinese Companies' Outward Investment intentions," Asia Pacific Foundation of Canada, November 2005.

Enterprises to Develop Overseas Business in Processing and Assembling the Supplied Materials to promote the establishment of manufacturing, processing, and assembly projects overseas involving Chinese materials in an effort to further Chinese exports.

- Stage 5 (2002-Present): The CCP's 16th Party Congress in 2002 formalized a Go Global policy in support of an over-arching strategy to open up the Chinese economy. The previous regulations governing a somewhat Byzantine approval were streamlined to further a Go Global strategy. In 2004, the State Council implemented a major pronouncement with the *Decision on Reforming the Investment System* in which the government's role shifted from approving to supervising and supporting Chinese enterprises abroad. In 2004, China's National Development and Reform Commission (NDRC), Foreign Ministry, and MOFTEC disseminated the *Guidance Catalog on Countries and Industries for Overseas Investment* which identified specific targets for Chinese investment. This list of specific geographic locations and specific industries stated, "Any enterprise that complies with Guidance Catalog and holds an overseas investment approval certificate...shall have priority to enjoy preferential treatment under policies of the State in respect to funding, foreign exchange, tax, customs, and import and export, etc."²⁰

The publication of such a catalog with its associated recommendations has greater implications for a country such as China than for a western market economy. Approximately three-quarters of Chinese ODI involve state-owned enterprises. The Chinese government's catalog is intended to point the way for companies, particularly SOEs, as they plan to go abroad. The 2004 catalog included recommendations for 67 countries and seven industrial sectors. Of the 67 countries, 26 were in Asia, 13 in Africa, 12 in Europe, 11 in the Americas, and 5 in Oceania. Recommended industrial sectors included electronics, manufacturing, and natural resources. Updated catalogs were published by NDRC in 2005 and 2007.²¹

The evolution of the central government's position on ODI resulted in a gradual relaxation of China's regulations in order to avoid competition and duplication by indigenous companies in overseas commercial activities as well as enhance and expand trade overall. In

²⁰ David Zweig, "A New Trading State Meets the Developing World," Hong Kong University of Science and Technology, Working Paper 31, 2010.

²¹ Schueler-Zhou, Schueller, and Brod, "Chinas Going Global – Finanzmarktkrise bietet Chancen fuer chinesische Investoren im Ausland," 4.

synthesis, the government made a series of policy decisions which directly resulted in adopting measures to facilitate Chinese overseas investments. It did this by establishing incentives, financial and other, to go abroad; streamlining administrative and approval requirements; relaxing controls for capital outflows; providing information and guidance for companies wanting to go abroad; and minimizing investment risks for Chinese companies in foreign markets.

NDRC and the Export-Import Bank of China established a preferential loan system for certain key projects abroad. These projects had to involve at least one of the following four aspects:

- Overseas development projects involving resources attainable abroad that are in scarce supply domestically.
- Overseas production and infrastructure projects that spur China's export of domestic technology, products, services, and labor.
- Overseas research and development projects that provide access to advanced foreign technologies and human capital skills.
- Mergers and acquisitions (M&A) of foreign companies that enhance Chinese companies' competitiveness globally and provide access to foreign markets.

The Chinese government offers tax incentives for Chinese foreign affiliates. They are exempt from taxes for the first five years after being set up. Thereafter, the foreign operations are taxable only on their earnings at the rate of 20 percent.²²

NDRC and MOFCOM (and its predecessor, MOFTEC) review and approve ODI requests. In 2004, these two organizations, respectively, enacted *Interim Measures for the Administration of Examination and Approval of the Overseas Investment Projects* and *Provisions on the Examination and Approval of Investment to Run Enterprises Abroad*. These seminal documents accomplished three major things. First, approval authority for overseas projects was decentralized to local levels. Second, procedures for approval were simplified to no longer

²² James Zhan, "Transnationalization and Outward Investment: the Case of Chinese Firms," *Transnational Corporations*, Vol. 4, No. 3 (December 1995).

require feasibility studies and other supporting documentation. Third, transparency was enhanced by increased use of online resources.

The Chinese central government has intended to link ODI to targeted industrial sectors and locations to China's long-term strategies. The State Administration for Foreign Exchange (SAFE) has been responsible for capital controls. With China's enormous growth in capital surplus, its overseas investments have increased accordingly. Over the years, SAFE has reformed and liberalized its practices gradually in order to allow Chinese companies operating abroad to invest profits overseas more readily. SAFE has also allowed its local bureaus to manage any deal of a value under \$10 million as well as giving its foreign exchange bureaus a U.S.\$5 billion quota in 2005. In all, the evolution in SAFE's policies gave Chinese companies greater access to foreign currency and allowed them to lend money to its overseas subsidiaries.

MOFCOM in 2004 released *Guidelines for Investments in Overseas Countries' Industries*. This document outlined the basis for overseas investments. It stipulated that Chinese companies given approval certificates for investments abroad would be authorized beneficial treatment related to capital acquisition, foreign exchange, taxation, customs duties, and other preferential government treatment. Additionally, MOFCOM set up an online data bank that provides information to Chinese companies related to investment opportunities abroad.

Moreover in 2004, MOFCOM established *Systems of Reporting Country Investment and Operation Obstacles* to decrease investment risks faced by Chinese companies abroad. By leveraging Chinese diplomatic missions and other Chinese commercial enterprises abroad, MOFCOM would highlight problems and challenges faced by companies in foreign markets so that potential investors were forewarned and forearmed. Plus, MOFCOM could protect Chinese companies overseas by engaging the host nation on their behalf in case issues did arise.

Five other documents were promulgated by MOFCOM since 2003 in conjunction with other government agencies in order to reduce investment risks for Chinese enterprises. They were *Statistical System of Direct Overseas Investment; Measures for Overseas Investment Comprehensive Performance Evaluation and Joint Annual Inspection; The Internet Registration*

System of Exploring Overseas Mineral Resources; and The Prophase Reporting System for the Overseas Merger and Acquisition Related Matters of Enterprises.

State support plays a critical role for Chinese enterprises that want to go abroad. Government assistance is not limited to only simplifying approval procedures needed for companies to go global. In addition to the various measures above that were gradually introduced, in May 2009, the approval process of any investments of under U.S.\$100 million was delegated from the central government in Beijing to the provincial level and even below.²³ Beijing provides subsidies and credits to Chinese companies attempting to enter key overseas markets involving energy projects and or technology acquisitions. Chinese state-owned banks have expanded their overseas presence to help facilitate ODI as well as to increase investments in overseas finance markets. For instance, from 2007 to 2008, Chinese investment in foreign finance sectors increased seven-fold to approximately U.S.\$14 billion. According to the Chinese Ministry of Commerce, this represented 25.1% of all of China's ODI for the year.²⁴

In April 2009, MOFCOM provided new guidelines for overseas investments. This time, the pseudo-catalog of recommended destinations for Chinese ODI covered 160+ foreign locations. Based on inputs from Chinese diplomatic missions abroad, the guidelines address opportunities, risks, and mitigating factors.²⁵

Also in 2009, the Chinese government also announced that it would be allocating a portion of its foreign reserves specifically to support Chinese enterprises' moves into foreign markets. Plus, the sovereign wealth fund, China Investment Corporation (CIC), began a targeted campaign to expand purchases of shares of foreign companies.²⁶

As the aforementioned data demonstrates, the Chinese central government has undertaken concrete steps since the early days of Chinese ODI. Its policies have evolved over the years to reform, streamline, and liberalize procedures, policies, services, and regimes to encourage, facilitate, and protect Chinese investments abroad. Arguably, this has resulted in a noticeable increase in the number of Chinese companies abroad and the total amount of ODI.

²³ Hu Yue, "Heading Abroad. China Eases the Rules on Overseas Investment to Help Domestic Companies Go Global, *Beijing Review*, April 2009, 13.

²⁴ MOFCOM Website, www.mofcom.gov.cn.

²⁵ "China issues new guidelines for overseas investment," *People's Daily*, April 10, 2009, <http://english.peoplesdaily.com.cn>.

²⁶ Schuler-Zhou, Schueller, and Brod, "Chinas Going Global – Finanzmarktkrise bietet Chancen fuer chinesische Investoren im Ausland," 4.

According to MOFCOM, the total number of Chinese enterprises abroad reached approximately 14,400 firms in 2010.²⁷

²⁷ MOFCOM Website, www.mofcom.gov.cn.

Chapter 2 - The Role of Commercial and Business Entities in Chinese Foreign Policy

The role of the firm in China's liberalization of the post-Mao economy became central early on. Since then, China's big companies had to undergo evolutionary change in order to become competitive internationally. China's leaders knew that they had to build powerful companies on the global stage in order for the country's economy to grow in a sustainable manner. Then Vice Premier Wu Bangguo stated in August 1998 that "Our nation's position in the international economic order will be to a large extent determined by the position of our nation's large enterprises and groups."²⁸

Influenced by the experience of the South Korean *chaebol* and Japanese *keiretsu* models, Beijing decided to select what Nolan called a "national team" of large industrial enterprises to nurture, favor, and support so that they could compete globally. These chosen few, referred to by *The Economist* as "national champions," were supported with favorable industrial policies, cheap real estate, preferential loans, and privileged access to stock listings.²⁹ Amongst the chosen were Sinopec (China National Petrochemical Corporation) and CNPC (China National Petroleum and Gas Corporation) in petroleum and petrochemicals; AVIC (Aviation Industries of China) in aerospace; the cities of Shanghai, Harbin, and Dongfang in power equipment; the cities of Yiqi, Erqi, and Shanghai in cars; and China Mobile and China Unicom in telecommunications.³⁰

In China, certain industrial and business sectors are deemed to comprise the core of the national economy. All corporations in these sectors, regardless of their shareholding structure, are required by law to be controlled or owned by the state (see Table 1). The sectors include power generation and distribution; oil, coal, petrochemicals, and natural gas; telecommunications; armaments; aviation and shipping; machinery and car production;

²⁸ Peter Nolan and Jin Zhang, "The Globalization Challenge for Large Firms from Developing Countries: the Case of China's Oil and Aerospace Industries," University of Cambridge, 3.

²⁹ "The Struggle of the Champions," *The Economist*, January 6, 2005.

³⁰ Nolan and Zhang, "The Globalization Challenge for Large Firms from Developing Countries: the Case of China's Oil and Aerospace Industries," 3.

information technologies; construction; and the production of iron, steel, and non-ferrous metals.³¹

Table 1: Chinese Companies Linked to Government

Company	Business	Share Owned by Government
Sinopec	Oil Production and distribution	84%
PetroChina	Oil Production and distribution	90%
China Mobile	Cellular Operator	75%
First Auto Works (FAW)	Auto maker	100%
China Minmetals	Mining	100%
Shanghai Automotive (SAIC)	Auto maker	100%
China Life	Insurance	73%
China Netcom	Fixed line phone operator	75%
Baoshan Iron & Steel	Steel	61%
CNOOC	Oil Exploration	71%
TCL	Consumer Electronics	25%
ZTE	Telecom networking equipment	53%
Lenovo	Computers	50%
China Merchants Bank	Bank	18%
Haier	Appliances, consumer electronics	30%
Konka	Consumer electronics	24%
Sinochem	Petrochemicals	43%
Changhong Electric	Consumer electronics, appliances	54%
Dongfeng Automobile	Auto maker	70%
Cosco	Shipping	52%

Source: BusinessWeek, August 22/29, 2005

The growing presence of Chinese commercial entities abroad has become a factor in China's foreign affairs. Foreign policy players in China are not limited to the government, the

³¹ Derek Scissors, "Deng Undone," *Foreign Affairs* 88, no. 3 (May/June 2009): 28.

CCP, and the military. In the case of modern China, the normal orbit of the foreign affairs community includes SOEs, financial institutions, and energy companies. This is not necessarily unique to China, but their role may be more exaggerated in China given the symbiotic relationship between business, government, and Party leaders. Additionally, China's focus on securing raw materials from offshore locations is accompanied by commercial, political, and security implications. The over-arching economic imperatives of growing the Chinese economy with its associated ODI, as described previously, also implies the important role that commercial entities play in foreign policy. Beijing's checkbook diplomacy is reliant on Chinese economic presence abroad and thus the companies involved have a role in determining the course of that diplomacy.

Chinese companies involved in industries described as being of strategic significance to the state have a bigger role within Chinese foreign policy. These industries include petroleum, minerals, and defense manufacturing. For instance, when formulating Chinese policy towards energy security, leaders of relevant large Chinese SOEs are members of the official government decision-making cycle. Executives of major SOEs under the central government, such as the China National Petroleum Corporation (CNPC), are appointed by the CCP's Central Committee's Organization Department. In fact, all executives of ministry-level SOEs are appointed by the Organization Department and approved by the Central Committee. Many commercial leaders hold ministerial or vice-ministerial rank and even serve as alternate members of the Central Committee.³²

Senior SOE leaders' participation in both state and party systems provides them with significant political connections or *guanxi* that allows for input into policy decisions related to their particular industries and interests. At times, the lines between Chinese company and Chinese government can become very blurry indeed. For example, two Ministry of Foreign Affairs (MFA) officials in recent years were seconded to CNPC offices in a particular country. After these assignments, the two officials became senior diplomats in the same country in which they recently served as CNPC officials.³³ This would be nearly impossible in most countries'

³² Linda Jakobson and Dean Knox, "New Foreign Policy Actors in China," SIPRI Policy Paper #26, September 2010.

³³ Jakobson and Knox, "New Foreign Policy Actors in China," 26.

diplomatic corps as this would be considered a distinct conflict of interest and illegal in most developed economies.

Chinese companies are often tools used to implement Beijing's foreign policy. Chinese foreign aid frequently consists of large infrastructure projects in third world countries that were financed by Chinese banks and constructed by Chinese companies. Many stadiums, roads, and hospitals were constructed by Chinese dollar diplomacy in Africa, Central Asia, the South Pacific, and the Caribbean Basin. The scope and scale of Chinese commercial activities abroad certainly dictate to what degree they are a factor in foreign policy. This is usually most clearly the case with China's energy companies in Africa and Central Asia.

Additionally, other key natural resource deals appear to heighten the inter-play between the Chinese central government and Chinese companies. In 2007, the China Metallurgical Construction Corporation bought the Aynak copper mine in Afghanistan. Media accounts reported widespread Chinese government pressure on the Afghan government, including alleged bribery charges of key Afghan leaders, in support of the Chinese acquisition attempt. The U.S.\$3.5 billion deal included a longer term Chinese commitment to develop power, rail, and health infrastructure in Afghanistan.³⁴

All Chinese companies have a CCP organization parallel to the corporate structure. This is a standard requirement and allows the CCP to be present, visible, and vigilant in business and commercial activities. Although Chinese SOEs have evolved in many respects after decades of reform, the role of the party is still critical. A Chief Executive Officer (CEO) of an SOE has to consider political factors that multinational companies' CEOs from other countries do not. The CEOs of the largest SOEs are actually appointed by the CCP's Central Organization Department. The State Assets Supervision and Administration Commission has a controlling stake in approximately 200 SOEs. It tracks and assesses the enterprises' activities. SASAC changed the leadership amongst the rival phone companies (China Telecom, China Unicom, and China Mobile) without any notice.³⁵ Obviously this ensures that Chinese companies' activities, both

³⁴ Jakobson and Knox, "New Foreign Policy Actors in China," 27.

³⁵ Frederik Balfour, "The State's Long Apron Strings," *Business Week*, August 22, 2005, 61.

domestically and abroad, are in line with the objectives of the CCP and the government. Chinese officials routinely cycle between corporate and government posts at the choosing of the CCP.³⁶

As evidenced in the previously cited example from the Chinese diplomatic ranks, official influence is also evident in other appointments. For example, in October 2003, Wei Liucheng became the Governor of the island province of Hainan. His previous job was CEO, Chairman of the Board, and CCP Secretary of China National Offshore Oil Corporation (CNOOC).³⁷

The significant link between the Party and the private sector is even apparent with China's most successful white goods manufacturer, Haier Group. This company arguably does not participate in any strategic industries. Instead, it is most famous in the U.S. for making small refrigerators ideal for college dormitories and wines. As Haier represents a very successful Chinese company both domestically and abroad, it has a certain elevated role. Thus, its chairman, Zhang Ruimin, was named as an alternate member to the Chinese Communist Party's Central Committee in 2002. He is one of only a few businessmen to have such a position which is indicative of his political connections.³⁸

The Export-Import Bank of China (Eximbank) and the China Development Bank (CDB) are major Chinese government controlled banks. While Eximbank is charged with expanding China's international trade, CDB is tasked with promoting China's economic and infrastructure development. They directly support the government's "going global" policies by providing loans to Chinese companies operating abroad as well as export credits and guarantees. Both Eximbank and CDB focus on companies involved in resource exploitation and infrastructure development projects overseas. This has meant a major role in supporting Chinese companies involved in mineral, petroleum, and telecommunications work overseas.

Eximbank is the only Chinese bank allowed to offer concessional loans and is a primary lender to foreign governments. As such, it is a major player in foreign aid allocation. On its website in 2007, the bank described its mission as:

³⁶ Scissors, "Deng Undone," 28.

³⁷ Wood and Brown, "China ODI: Buying into the Global Economy," 30.

³⁸ Yibing Wu, "China's Refrigerator Magnate," *The McKinsey Quarterly*, no. 3 (2003): 109.

“to implement the state policies in industry, foreign trade, diplomacy, economy and finance...”³⁹

In 2009, Eximbank provided a U.S.\$5 billion loan for an oil project to the Development Bank of Kazakhstan. This was part of a deal that provided CNPC with a 50% share in one of Kazakhstan’s largest oil and gas conglomerates. Eximbank is also a State Council policy bank. This coupled with its foreign aid role gives Eximbank a connection to and a voice in the foreign policy formulation process as relates to trade and investment.

In 2004, the China Development Bank provided a low-cost loan of U.S.\$10 billion to the telecommunications equipment manufacturer Huawei Technologies in order to aid expansion of its overseas operations.⁴⁰ The CDB in 2007 founded a U.S.\$5 billion China-Africa Development fund. This is a for-profit investment fund designed to improve China’s commercial connections to Africa. In 2009, CDB provided the Russian oil and pipeline companies Rosneft and Transneft with a U.S.\$25 billion loan. Shortly after that deal, a Russo-Chinese pipeline was finally agreed to which had been the subject of tense negotiations since 1994. Also in 2009, the CDB provided a U.S.\$10 billion loan to Brazil’s biggest oil producer, Petrobras. In return, China received a 10 year oil supply accord. Moreover, CDB established a joint venture bank in Pakistan intended to support Chinese companies involved in infrastructure and manufacturing. In the West, CDB provided U.S.\$3 billion in 2007 for a major stake in the British bank, Barclays.⁴¹

CDB’s unique relevance and influence is further underscored by the bank chairman’s ministerial rank in China. Furthermore, the CDB has its own policy research arm and focuses on economic development.

There is a distinct advantage for China in having much of its foreign investments carried out by state-owned enterprises. The SOEs lack the transparency required of western competitors who are required to publish annual reports for shareholders. They have ready access to capital provided by the central government. They have the luxury of being able to hold long term, strategic views integrated with national government priorities instead of chasing short term profit

³⁹ China Eximbank website, <http://english.eximbank.gov.cn/>.

⁴⁰ “China Mobile Bids to Take Her First Global Step,” *China Daily*, March 15, 2005.

⁴¹ Bill Powell, “Enter the Dragon,” *Time*, August 2, 2007, <http://www.time.com/time/magazine/article/0,9171,1649318,00.html>.

and stock gains as well as worrying about constituencies other than the government and party leadership.⁴²

⁴² Congressional Research Service Report, *China's Foreign Policy: What Does it Mean for U.S. Global Interests?*, report prepared by Kerry Dumbaugh, July 18, 2008, 13.

Chapter 3 – Reasons for “Going Global”

China’s overseas investment has become a fact and an increasing trend for the Chinese economy for a variety of reasons. Some have argued that it represents a wider process of economic liberalization and restructuring in which the central government, rather than private sector entrepreneurship, played the leading role. Beijing’s push for Chinese investments overseas is rooted in both market fundamentals as well as by the realities of globalization and regionalization. Additionally, geopolitical and strategic considerations figure prominently in China’s decisions to invest abroad.⁴³

There is ample literature on objectives of and motivations for ODI. The United Nations’ Department of Economic and Social Development, Transnational Corporations and Management Division (UN TCMD) identifies five main categories of developing countries’ enterprises’ foreign direct investment. These are: market seeking FDI, export focused FDI, resource seeking FDI, technology seeking FDI, and efficiency seeking FDI.⁴⁴ The Organization for Economic Cooperation and Development (OECD) identifies, in the specific case of China, five broad categories behind Chinese ODI: resource seeking, market seeking, strategic asset seeking, diversification seeking, and efficiency seeking.⁴⁵ Zhan cites the following motives behind Chinese ODI: securing a stable supply of natural resources that are not available in China in the quantities required; adding to China’s foreign reserves; generating opportunities for increased Chinese exports; providing access to advanced technology and human capital otherwise unavailable in China; contributing to stronger economic ties between China and certain countries which could strengthen political ties as well.⁴⁶

Some studies have tried to synthesize Chinese companies’ motives for driving operations overseas in the following points:

- Trading companies want to open up new markets;

⁴³ Mark Yaolin Wang, “The Motivations Behind China’s Government Initiated Industrial Investments Overseas,” *Pacific Affairs*, Summer 2002.

⁴⁴ UN-TCMD, *Transnational Corporations from Developing Countries: Impact on their Home Countries*, (New York: United Nations, 1993), 11-14.

⁴⁵ Wood and Brown, “China ODI: Buying into the Global Economy,” 29.

⁴⁶ Zhan, “Transnationalization and Outward Investment: the case of Chinese Firms.”

- Manufacturing companies want to avoid saturating home markets as well as avoid trade barriers of other countries;
- Secure access to raw materials, energy supplies, and natural resources;
- Acquire advanced technology and manufacturing skills;
- Obtain internationally recognized brands;
- Learn advanced management methods;
- Leverage foreign preferential investment policies;
- Reduce production costs;
- Transfer excess production capacity.⁴⁷

From late 1988 to mid 1989, a survey was conducted to ascertain motives for Chinese investment abroad. The survey was carried out by Fudan University in Shanghai under the supervision of MOFTEC's International Economic Cooperation Bureau. The survey offered respondents 18 possible reasons for Chinese companies to operate overseas. The top six reasons cited included: to create conditions for other business activities; to open up new markets; to acquire first-hand information on foreign production and market; to promote exports of capital goods, materials, and labor; acquire foreign capital technology and management skills; and to leverage preferential terms offered by the government.⁴⁸

The Chinese government's worldwide political and economic agenda are key factors in pushing companies to go abroad. With the expansion of economic ties bilaterally and multilaterally, Beijing is able to increase its political clout and influence in those same locations, not to mention neighboring areas. It is apparent that China's outward economic involvement, as observed in its means and ends, is clearly aligned with its global strategy to enhance its global political presence. In fact, business and political (state and party) leaders work jointly to strengthen Chinese relationships with countries and regions.

Given the above review of the literature, it can be concluded that there are several common economic denominators in the search for motives behind Chinese ODI. They are assuring access to foreign markets and natural resources as well as advanced technology and intellectual property.

⁴⁷ Zhang, "Going Global: The Why, When, Where, and How of Chinese Companies' Outward Investment intentions," 13.

⁴⁸ Ye Gang, "Chinese Transnational Companies," Shanghai Research Institute of Economy and Trade.

Seeking markets is the main reason for the majority of China's outbound investment. This is in line with the export driven economy that has been established since the late 1970s in China. Chinese firms need to go abroad to assure consistent access to customers in order to sell domestically produced goods. In the manufacturing sector, the Chinese domestic demand is at its zenith and there may even be large excess production capacity in some sub-sectors such as textiles, footwear, and electrical gear. China's economy is dependent on exports; the factories run on foreign orders. As was evidenced by the most recent global economic recession, China's factories were directly impacted when orders started to dry up. An over-dependence and reliance on the markets of North America and Western Europe has been expanded to the emerging markets of Africa, Latin America, Eurasia, and Southeast Asia. Correspondingly, Chinese service companies followed established export channels to support Chinese manufacturers in order to more effectively market their goods to an overseas customer base. Furthermore, these trade enhancing firms served as a forward receptor of market indicators on demand. Avoiding tariffs and other trade barriers also motivates Chinese companies to expand overseas.

China's per capita availability of natural resources is relatively low. China is going abroad to assure consistent access to natural resources. From the beginning of China's going global days, the search for natural resources has been a primary priority for the central government's directives in Chinese overseas direct investment. The focus has been on oil and natural gas to fuel China's growing domestic economy and industry. However, copper, tin, aluminum, iron ore, lumber, and other raw materials have increasingly come to the fore as Chinese companies want to ensure long term access to the materials needed in their export driven economy.

Seeking strategic assets is a central theme for Chinese companies overseas. They go abroad to acquire a name brand, a technology, an expertise or something else (tangible or otherwise) that cannot be produced indigenously or independently. Chinese companies in the fields of aviation, space, electronics, and engineering have sought to establish themselves abroad via various means in order to channel back to China key technologies to upgrade their manufacturing capabilities. The same applies to research and development efforts. For instance, in 1988, Shougang Corporation bought a 70% stake in the Masta Engineering Company, an

American firm. Masta is known internationally as a top player in designing and building metallurgical equipment. With its majority stake in Masta, Shougang acquired, almost overnight, access to all of Masta's plans, blueprints, patents, and technologies.⁴⁹ This translates into an ability to leapfrog to a level of capacity and capability previously unreachable in such a short time frame.

Another example of the aforementioned was the purchase of Volvo, the iconic Swedish car manufacturer, by the lesser known Zhejiang Geely Holding Group in 2010. With its U.S.\$1.8 billion acquisition, Geely not only obtained the know-how of how to manage an international supply chain and a global dealer network. It also acquired Volvo's famous intellectual property concerning safety which has been a major shortcoming in Chinese domestically produced cars.⁵⁰ The spokesman of the Chinese Ministry of Commerce clearly stated that the Volvo deal will provide China with much needed technology for its automotive industry.⁵¹

A key element still missing in China's growing economic and business prowess is international name recognition. By buying established, foreign brand names such as IBM or Maytag, Chinese companies are able to acquire an internationally recognized brand overnight. Acquiring foreign firms' intellectual property allows for leap frogging technologies for the Chinese buyer.

In sum, Chinese enterprises are trying to strengthen their control over and their access to natural resources that are necessary to continue fueling China's rapid economic growth. Acquiring overseas assets, for example oil and gas, is high on the agenda for the government and therefore state-owned companies such as Petrol China, Sinopec, and CNOOC are rapidly expanding overseas in order to acquire foreign assets that can help China to continue fuelling this economic growth. Finally, ironically, while entry into the World Trade Organization opened up the China market for foreign companies and therefore resulted in increased domestic competition, it has also paved a path for Chinese companies to expand overseas, to build up their

⁴⁹ Zhan, "Transnationalization and Outward Investment: the case of Chinese Firms."

⁵⁰ "Geely Buys Volvo," *The Economist*, April 3, 2010, 60-61.

⁵¹ "Geely's US\$2B Volvo Deal a Test Run for Foreign Takeovers," *South China Morning Post*, February 6, 2010, 8.

own capabilities, and to compete more effectively and profitably at home in the China market and abroad in foreign markets.

Chapter 4 - Chinese ODI Sectors and Actors

Over the past decade, China's acquisitions overseas have equated to U.S.\$187 billion worth of international mergers and acquisitions (M&A) activity. Based on 2009 figures, this has propelled China to the third spot globally after the United States and France in terms of foreign M&A investor nations. This reflects a significant rise in the ranks from 12th approximately 10 years ago. Most of Chinese ODI is focused on the Asia-Pacific region (52% in 2009). Yet, China was also the second largest investor in both Australia and Canada in 2009. Globally, China is the largest overseas investor in the energy and power sector and the second largest in the raw materials sector.⁵²

According to MOFCOM data, approximately 14,400 Chinese companies have a presence in foreign countries. As has been the case since the going global campaign was initiated, the majority of the Chinese firms abroad are State Owned Enterprises and they remain particularly focused on the energy and natural resources sectors.

The role of natural resources in China's ODI has been central. This is based on a variety of factors. The Chinese state and party leadership is unwilling to base the continued growth of the Chinese economy on the ability of the markets to regulate and insure an uninterrupted supply of the natural resources the country needs. Beijing is also concerned that global supply may not be able to keep pace with China's ever-expanding demand for natural resources. This may be exacerbated by global competition for these scarce resources. All of this is occurring with the backdrop of an acute Chinese shortage of many of these resources. During the 1990s, the Chinese government began to direct its oil industry state-owned enterprises to make significant investments overseas in oil and gas resources as wells as in the transportation networks meant to supply China.

In terms of energy resources, China did not become a net importer of oil until 1993 (see Table 2). Since importing 6% of its oil in 1993, the figure has grown to 42% in 2005, 49% in 2008, and exceeding 50% in 2009. The percentage of dependence on foreign oil is predicted to rise to 70% by 2020.⁵³ In March 2007, China announced nine countries as suitable for

⁵² "FACTBOX: China's outbound M&A in 2009 and the past decade," Thomson Reuters, January 20, 2010, <http://in.reuters.com>.

⁵³ Wood and Brown, "China ODI: Buying into the Global Economy," 34.

investment by the nation's oil companies. The nine countries are: Bolivia, Ecuador, Kuwait, Libya, Morocco, Niger, Norway, Oman and Qatar.⁵⁴ Initially, Chinese ODI focused on relatively low-risk projects involving oil field rehabilitation and development, and the service provisions. Subsequently, CNPC, CNOOC, and Sinopec expanded their activities substantially (see Table 3).⁵⁵ The latter has focused its efforts on refinery projects while the former companies have focused on exploration and production projects.

Table 2: Chinese oil production and consumption (million tons per year)

	1970	1980	1990	2000	2005	2006	2007
Production	30.7	106.0	138.3	162.6	180.8	183.7	186.7
Consumption	28.2	85.4	112.8	209.6	327.8	353.3	368.0

Source: BP Statistical Review of World Energy, historical dataset. See www.bp.com.

Table 3: Countries where Chinese companies are operators of one or more concessions

Company	Countries
CNPC	Algeria, Azerbaijan, Chad, Ecuador, Equatorial Guinea, Indonesia, Iraq, Kazakhstan, Mauritania, Niger, Nigeria, Peru, Sudan, Syria, Thailand, Turkmenistan, Venezuela
CNOOC	Equatorial Guinea, Indonesia, Kenya, Burma, Philippines
Sinopec	Australia, Saudi Arabia, Ecuador
Sinochem	United Arab Emirates

Sources: Company web sites and U.S. Energy Information Administration

The year 2009 saw a particularly high level of activity in the petroleum sector. SINOPEC bought the Swiss firm Addax Petroleum for U.S.\$7.56 billion.⁵⁶ In March 2009, CNPC bought the Canadian based Verenex Energy for U.S.\$390 million. This company owns

⁵⁴ Au Loong Yu and Kevin Li, "Preliminary Report on China's Going Global Strategy," *Globalization Monitor Limited*, February 2009, 27-28

⁵⁵ Andrews-Speed and Vinogradov, "China's Involvement in Central Asian Petroleum," 389.

⁵⁶ Schuler-Zhou, Schueller, and Brod, "Chinas Going Global – Finanzmarktkrise bietet Chancen fuer chinesische Investoren im Ausland," 3.

50% of a major Libyan oilfield. One month prior, the China Development Bank and the China Petroleum and Oil Company invested U.S.\$10 billion in Brazil's Petrobras which is the prime operator of one of the world's most recently discovered offshore oil fields. Only two days prior to the Petrobras deal, China loaned U.S.\$15 billion to Rosneft and U.S.\$10 billion to Transneft, both key Russian oil and pipeline firms.⁵⁷ The terms of the Brazilian and Russian deals call for the loan repayments to be made in deliveries of crude oil, not cash, stabilized at prices that are arguably much lower than the market prices.

In terms of mineral resources, China only possesses approximately 58% of the world average of what is required to meet its needs.⁵⁸ China's profound growth and development over the past three decades is illustrated by the percentage of consumption of the world's resources. As the factory for many of the world's consumer goods, China is reliant on raw materials to fuel its export driven industries. Various sources cite the Chinese need for raw materials. The appropriately named article "China Eats the World" underscores this historic phenomenon. The article states that China's portion of the global consumption of aluminum, copper, iron ore, and nickel doubled from 7% in 1990 to 15% in 2000 and by 2004 reached approximately 20%.⁵⁹ According to another report in 2005, it was estimated that China consumed the following percentages of the following raw materials: cement - 47%, cotton - 37%, rice - 32%, coal - 30%, crude steel - 26%, aluminum - 21%, copper - 20%, wheat - 16%, and oil - 8%.⁶⁰ Furthermore, a third report stated that while China consumed only 10% of the world's copper supplies in 1997, by 2007 this figure grew to 23%. The annual rate of increase in demand for copper is 12.5% for China while the rest of the world it is only 1.5%.⁶¹

In recent years, Chinese officials have viewed the global financial crisis as an opportunity to acquire stakes in international supplies of strategic natural resources (see Table 4). The leadership in Beijing fully realizes that the country will need such resources in the years to come and is thus directing investments into these sectors in order to leverage the lower prices for these commodities. China's focus on Australia in the last two years is telling. This has been underscored by the efforts of the Aluminum Corporation of China (Chinalco), China Minmetals,

⁵⁷ Bill Powell, "Buying Binge," *Time*, March 16, 2009, 26-27.

⁵⁸ Wood and Brown, "China ODI: Buying into the Global Economy," 34.

⁵⁹ Andy Rothman, "China Eats the World: The Sustainability of Chinese Commodities Demand," Credit Lyonnais Securities Asia, March 2005.

⁶⁰ Pete Engardio, "A New World Economy," *Business Week*, August 22, 2005, 43.

⁶¹ Johannes Heinritzi, "Noch Viel Aufzulegen," *Focus-Money*, November 2007, 77.

and Hunan Valin Iron and Steel Group of China to acquire major holdings of the Australian firms Rio Tinto, Oz Metals, and Fortescue Metals Group, respectively.⁶² Despite China possessing profound reserves of coal, Yanzhou Coal Mining Company purchased the Australian coal mine operator Felix Resources Limited for US\$2.9 billion dollars.⁶³

Table 4: Profile of Chinese mining companies with overseas operations

Company	Focus	Type
Aluminum Corporation of China (Chinalco)	Mainly bauxite and aluminum	SOE
Baosteel Group Corporation	Iron and steel	SOE
Nanchuan/Bosai	Bauxite	Private
China Machinery and Electrical Equipment Export and Import Company (CMEC)	Engineering, construction, power stations, energy, mining	SOE
China Metallurgical Group Corporation (MCC)	Engineering, construction; mining	SOE
China Minmetals Corporation	Metals mining and trading	SOE
China National Geological and Mining Corp. (CGM)	Metals production and trading	SOE
China Non-Ferrous Metals Mining Group (CNMC)	Engineering, construction, mining	SOE
Jinchuan	Nickel and platinum	SOE
Luanhe Industrial Group	Steel and mining	Private
Shenhua Group Corporation	Coal and Power generation	SOE
Shougang Group	Iron and Steel	SOE
Sinosteel	Steel and mining	
Tonghua iron and Steel	Iron and steel	SOE
Wuhan Iron and Steel	Iron and steel	SOE
Yankuang	Coal	SOE

Sources: Company web sites, industry newsletters

It can be concluded that the Chinese acquisitions in the sectors of petroleum and other natural resources have been guided by Beijing for several reasons. First, the Chinese government has clearly identified a need, perhaps even a dependence, on natural resources that it can not supply indigenously in adequate quantities. In fact, this dependence has increased over

⁶² Powell, "Buying Binge," 26.

⁶³ Schueler-Zhou, Schueller, and Brod, "Chinas Going Global – Finanzmarktkrise bietet Chancen fuer chinesische Investoren im Ausland," 3.

the past years. An additional report cited China's dependence on imported oil has grown from 31% in 2000 to 41% in 2010 and is estimated to reach 58% by 2020. The percentage of dependence on imported copper grew from 48% in 2000 to 72% in 2010 and should hit 82% in 2020. The need to import zinc went from 0 in 2000 to 53% in 2010 and is projected to reach 69% in 2020.⁶⁴ These resources are required to sustain overall economic growth.

Chinese firms have also focused efforts on acquiring high technology companies abroad. Acquiring technology overseas is a key element in China's overall going global strategy as outlined previously. Additionally, acquiring brand recognition, human capital, and leapfrogging links in the value chain are also clear imperatives of going global. The most well known Chinese case to date that entailed all of the aforementioned was Lenovo's U.S.\$1.75 billion take over of the IBM personal computer (PC) division, including manufacturing and research and development, in 2004-2005. Legend, the company's name prior to rebranding itself as Lenov, had reached its peak in 2002 with 30% of the PC market share in China. The IBM PC acquisition was prompted, in part, by the Chinese company realizing it was losing its domestic market share to new actors in China such as the American companies Dell and Hewlett-Packard.

The deal immediately provided Lenovo with the additional technologies and capabilities required to transform itself into a global player in the PC industry. This included acquiring global management talent, a valuable brand, access to global channels and customers, a well-established global management system and a global operations footprint. The deal included a five-year brand licensing agreement; the acquisition of globally-recognized trademarks such as the ThinkPad; a long-term strategic alliance whereby IBM sells Lenovo products to corporate customers globally; and an arrangement for IBM to provide Lenovo with various support services worldwide. Lenovo's president Yang Yuanging stated the takeover allowed the company to accelerate its global expansion plans by 10 to 20 years, whereas growing organically would have cost it more than U.S.\$2 billion.⁶⁵

⁶⁴ Wood and Brown, "China ODI: Buying into the Global Economy," 34.

⁶⁵ "Going Global Poses New Challenges for Chinese Companies," Singapore Management University, <http://knowledge.smu.edu.sg/article.cfm?articleid=1159>.

Timing has also played a significant role in Chinese ODI. The most recent global recession has provided Chinese investors with an opportunity to invest now in resources for the future while locking in current, and sometimes even more competitive, prices. For instance, the previously discussed Chinese deal with the Russian Rosneft and Transneft allowed China to lock in oil prices for 20 years at the cost of approximately U.S.\$20 per barrel, notably lower than prevailing rates.⁶⁶ Ample evidence exists also for U.S. and European Union based firms finding themselves in dire financial straits and dependent on government injections of capital for commercial survival. These firms also became objects for Chinese investments as China is exploiting opportunities to go “bottom-fishing.”⁶⁷ On 3 December 2009, the Xian Aircraft Industry Group, Company Limited (XAC) bought a controlling stake in the Austrian aircraft component company Fischer Advanced Composite Components (FACC). After a capital increase from EUR 40 million to EUR 80 million, XAC holds 95.625% of all FACC shares⁶⁸ This company was under substantial financial stress and would not have been able to sustain itself without outside assistance. In short, while worldwide ODI declined by approximately 20% in 2008, Chinese ODI actually doubled.⁶⁹

Profiles of Major Chinese Companies Abroad

China’s corporate prowess has grown internationally over the past several decades (see Table 5). In 2009, when Forbes published its list of the world’s biggest companies (based on sales, profits, assets, and market value), China was represented by 91 members.⁷⁰ Two years prior, China only had 44 members.⁷¹

⁶⁶ Powell, “Buying Binge,” 27.

⁶⁷ Dexter Roberts and Frederik Balfour, “China’s Shopping Spree,” *BusinessWeek*, July 27, 2009, 40.

⁶⁸ FACC website, <http://www.facc.at/en/ueberuns/index.asp?dat=history>.

⁶⁹ Ken Davies, “While Global FDI Falls, China’s Outward FDI Doubles,” *Columbia FDI Perspectives*, www.vcc.columbia.edu/documents/DaviesPerspectives-final.pdf.

⁷⁰ “The World’s Biggest Public Companies,” *Forbes Asia*, April 27, 2009, 35.

⁷¹ “2000 World Leaders,” *Forbes*, April 16, 2007, 135.

Table 5: Top 10 Chinese Companies by Chinese Overseas Direct Investment Stock, 2007

1	China National Petroleum Corporation (CNPC)
2	China Petrochemical Corporation (SINOPEC)
3	China National Offshore Oil Corporation (CNOOC)
4	China Ocean Shipping (Group) Company (COSCO)
5	China Resources (Holdings) Co., Ltd (CRC)
6	China International Trust & Investment Corporation (CITIC)
7	China National Cereals, Oils & Foodstuffs Corp. (COFCO)
8	China Mobile Communications Corp. (China Mobile)
9	Sinochem Corporation (SINOCHEM)
10	China Merchants Group (China Merchants)

Source: XRG C-ODI Report (October 2009)

Petroleum Companies

China's biggest producer and supplier of crude oil and natural gas is China National Petroleum Corporation (CNPC). It is also a major supplier and producer of refined petroleum and petrochemical products and one of the largest international players in the global petroleum and petrochemical industries. CNPC has dozens of oil and gas exploration, development, and production projects in the Middle East, North Africa, Central Asia, Russia, and South America. By 2003, CNPC's annual crude oil production surpassed 122 million tons and its annual natural gas production reached more than 26 billion cubic meters. By the end of 2003, CNPC's total investments abroad totaled more than U.S.\$4 billion in 19 countries.⁷²

⁷² Zhang, "Going Global: The Why, When, Where, and How of Chinese Companies' Outward Investment intentions," 35.

In August 2005, CNPC bought Petro-Kazakhstan for U.S.\$4.2 billion. In that same year, CNPC committed to investing U.S.\$400 million in developing 15 oil fields in Venezuela. In Uzbekistan, CNPC entered into a 50:50 joint venture to invest in developing 23 oil fields.⁷³

China National Offshore Oil Corporation (CNOOC) is state-owned oil company that was incorporated in 1982. The Chinese government has positioned CNOOC to be a primary actor in the exploration and exploitation of oil and gas reserves in China's offshore in cooperation with foreign partners. Its primary business sectors include oil and gas exploration and development, technical services, logistic services, chemical and fertilizer production, natural gas and power generation, and financial services.

In 2002, CNOOC paid U.S.\$585 million for the Indonesian oil operations of Repsol, making CNOOC the largest offshore oil producer in Indonesia. The deal included the purchase of the equivalent of approximately 360 million barrels of oil boosting CNOOC's production by approximately 17%. In 2003, CNOOC acquired a 12.5% stake in the huge Gorgon natural gas field off the coast of western Australia. That year, CNOOC also paid U.S.\$347 million for an interest in the upstream production and reserves of Australia's North West Shelf Gas Project.

Perhaps better known than any of its successful acquisitions is the failed attempt to buy the U.S. firm UNOCAL in 2005. CNOOC offered U.S.\$18.5 billion, but due to intense political pressure, particularly from the U.S. Congress, withdrew its offer.⁷⁴

Sinopec is the primary Chinese refining company. It also produces about 25% of China's domestic crude oil. In 2004, its revenues had already reached U.S.\$72.8 billion. In that same year, Sinopec purchased the U.S. energy group First International Oil Corporation for U.S.\$153 million. This U.S.-based company had assets in Kazakhstan. In May 2005, Sinopec acquired a stake in Canada's Northern Lights oil sands project for U.S.\$84 million.⁷⁵

Communications Companies

Huawei is a major Chinese manufacturer of wireless telecommunications and networking equipment founded by a former Chinese Army officer in 1988. In fact, today Huawei is China's

⁷³ "China Spreads its Wings – Chinese Companies Go Global," <http://www.accenture.com/>.

⁷⁴ Zhang, "Going Global: The Why, When, Where, and How of Chinese Companies' Outward Investment intentions," 35-36.

⁷⁵ "China Spreads its Wings – Chinese Companies Go Global," <http://www.accenture.com/>.

largest telecommunications equipment manufacturer with sales of over U.S.\$ 8.2 billion in 2005. Within 20 years of its founding, Huawei rose to become the fourth largest producer of network equipment in the world. Its initial overseas activities began in 1996 with a focus towards the emerging markets of Africa and Asia. It aggressively expanded in Africa, India, and Asia primarily by offering massive discounts of as much as 50% when compared to its Western competitors. By 2005, more than 50% of Huawei's revenues came from outside China. Huawei has successfully competed against European and U.S. competitors to supply equipment to major operators such as British Telecom, T-Mobile, Vodafone, Telefonica, and Cox Communications.⁷⁶ The Libyan firm, Syrte, awarded Huawei in 2009 a €12 million contract to construct fiber optic lines in Tripoli for next generation network services.⁷⁷ Its successful combination of low prices, aggressive marketing, and service quality have opened doors all over the globe, but particularly in the developing world.

Huawei's main Chinese competitor is ZTE Corporation which was founded in 1985 and is based in Shenzhen (as is Huawei). In 2008, ZTE was the world's eighth-largest maker of network equipment and sixth-largest maker of telephone handsets. ZTE is part of the Chinese State Council's "China Torch Program." This is a state sponsored strategic initiative designed to develop indigenous high technology capabilities with a particular emphasis on expanding markets for high tech Chinese products abroad. ZTE is publicly traded in Hong Kong. The public offering was part of a strategy to provide the company with a stronger financial platform for going abroad. ZTE's initial forays into the global market also focused on emerging economies. ZTE served telecom providers in Egypt, Indonesia, India, Pakistan, and Russia with various types of equipment.⁷⁸ In 2009, ZTE won a €41 million contract from Libya's telecommunications company, Libyana to expand its network.⁷⁹

Legend, China's largest computer maker, launched Lenovo as its global brand to position itself for overseas expansion with its historic purchase of IBM PC division in 2004-2005. Prior to the IBM acquisition, the Hong-Kong based (though Chinese controlled) Legend Group was 54% owned by Beijing-based Legend Holdings and 46% owned by other shareholders. Legend

⁷⁶ "Up, Up, and Huawei," *The Economist*, September 26, 2009, 12.

⁷⁷ "ZTE Corp Wins €41M Contract," *South China Morning Post*, September 13, 2009, B2.

⁷⁸ "China Spreads its Wings – Chinese Companies Go Global," <http://www.accenture.com/>.

⁷⁹ "ZTE Corp Wins €41M Contract," B2.

Holdings, in turn, was 65% government-owned with 35% owned by its staff. By associating itself with a top brand name, this Chinese company quickly raised its international profile as well as gained instant access to new markets. With its IBM PC purchase, Lenovo, a company barely known outside China, became the world's third-largest PC manufacturer after Dell and Hewlett-Packard amassing a combined turnover of U.S.\$13 billion. Lenovo's stock price increased by more than 60% during the period July-December 2005 widely interpreted as an indication of investors' endorsement of the deal.⁸⁰ In 2007-2008, Lenovo's sales reached U.S.\$16.4 billion, a 17% increase from the previous year, while achieving a pre-tax income of U.S.\$560 million, up 237%, while maintaining cash reserves of U.S.\$1.6 billion.⁸¹

Lenovo's long term globalization strategy is exemplified by its dual headquarters in Beijing, China and in Raleigh, North Carolina in the U.S. as well as its decision to establish its global marketing communications hub in India all indicative of growing international ambitions.⁸² Lenovo announced in 2007 that it would no longer use the IBM brand name on its products. This demonstrated the corporation's confidence in its own brand appeal and declining its right to continue to use the IBM name on its products. Instead, the IBM ThinkPads became rebranded Lenovo Thinkpads without any IBM logos earlier than anticipated after the 2004-2005 acquisition.⁸³

Consumer Goods Manufacturers

Incorporated in 1984, Haier Group's humble beginnings as the Qingdao Refrigerator Factory are hardly noticeable now that it is the world's fourth-largest appliance manufacturer. Over the past 20 years, Haier has produced more than 100 million appliances to consumers worldwide. Haier provides a wide range of home appliances and consumer electronic products through a worldwide network of sales and marketing offices covering 168 countries. By 2007, it reached a turnover of U.S.\$16.2 billion.⁸⁴ Haier Group's unique advantage is its culture of continuous innovation imbued into the company by its chairman, Zhang Ruimin. Haier runs 10

⁸⁰ "Going Global; Prospects and Challenges for Chinese Companies on the World Stage," IBM Institute for Business Value, 2006, 10.

⁸¹ "Going Global Poses New Challenges for Chinese Companies," Singapore Management University, <http://knowledge.smu.edu.sg/article.cfm?articleid=1159>.

⁸² "Top 10 Brands Likely to go Global," *Media*, December 14, 2007, 51.

⁸³ Jane Spencer, "Lenovo Will Shed IBM Name Early," *The Wall Street Journal Asia*, November 2, 2007, 4.

⁸⁴ "Going Global Poses New Challenges for Chinese Companies," Singapore Management University, <http://knowledge.smu.edu.sg/article.cfm?articleid=1159>.

design institutes and its extensive range of products are sold in markets across the Middle East, south and southeast Asia, Europe and the U.S. Haier is known worldwide for its ability to meet the specific niche needs of its global customers. For instance, it designed a refrigerator specifically meant for the desert environment of the Middle East. It has factories in over a dozen countries as diverse as the United States and Pakistan. The Haier Group considers itself an employee-owned collective, not a strictly state-owned enterprise. Some of Haier's assets are listed on the Hong Kong and Shanghai stock exchanges. Little is known about its main stakeholders.⁸⁵ Despite the global scale of its operations, ownership of the Haier Group is not clear as its governance structure and its practices are not common to corporations in developed economies.⁸⁶

Automobile Manufacturers

The top Chinese car producer is the Shanghai Automobile Industries Corporation (SAIC). In 2008, SAIC merged with Nanjing Automobile Corporation representing the biggest consolidation of the Chinese car industry which includes almost 100 companies (*China Daily*, 12 April 2008: S10). With this merger, the two firms expect to realize economies of scale and scope to maximize efficiencies and reduce overlap and redundancy. SAIC is now the purveyor of the famed British MG brand and is now producing MGs in a Nanjing suburb. SAIC hopes to capitalize on MG's established sales network in Europe and China's low production costs to be successful in Western markets.⁸⁷

Great Wall Motor Company Limited is China's biggest manufacturer of sport utility vehicles and pick-up trucks. The company became privately owned in 1991 after being a village-owned enterprise formed during the early years of Deng's economic liberalization. Initially focused strictly on the domestic market, Great Wall's exports have increased annually since 2000 at an amazing rate of 90%.⁸⁸ The CEO, Wang Fengying, set as a company goal that exports were to account for half of all sales. Great Wall Motor Company has established vehicle plants in Russia, Ukraine, Iran, Vietnam, Indonesia, and Nigeria. Plus, the company is expanding its sales and service presence overseas to better serve its customers.

⁸⁵ Zhou Yang, "Haier's Chairman on His Quest for a Global Brand," *The Wall Street Journal*, March 12, 2007, 31.

⁸⁶ Yibing Wu, "China's Refrigerator Magnate," pg. 108.

⁸⁷ Kandy Wang, "SAIC Motor Gears Up for US, UK Markets," *South China Morning Post*, February 10, 2010, B4.

⁸⁸ Fangfang Li, "Revving Up Overseas," *China Business Weekly*, April 21-27, 2008, 12.

Chapter 5 - Soft Power Implications of Chinese Companies Going Global

Soft power is a term widely used today in international relations by analysts, diplomats, academicians, and politicians. It is defined as the ability to obtain what one wants through co-option and attraction. The idea of attraction as a form of power and influence dates back to the ancient Chinese philosopher Laozi in the 7th century BC. Yet, the actual term soft term was most famously coined by Professor Joseph Nye of Harvard University in a 1990 book, *Bound to Lead: The Changing Nature of American Power*. Subsequently, Nye developed the concept further in his 2004 book, *Soft Power: The Means to Success in World Politics*. The main means of soft power include an actor's values, culture, policies and institutions or at least the manner in which these are interpreted in other countries. Furthermore, the extent to which these "primary currencies", as Nye wrote, are able to attract or repel other actors to "want what you want" is the critical aspect of soft power. According to Nye, "soft power rests on the ability to shape the preferences of others...it is the ability to get what you want through attraction rather than coercion or payments..."⁸⁹

Soft power is often associated with the rise of globalization and neoliberal international relations theory. Soft power's success significantly relies on the actor's reputation within the international community, as well as the flow of information between actors. Popular culture and media is regularly identified as a source of soft power, as is the spread of a national language, or a particular set of normative structures. A country with a great amount of soft power will engender good will abroad. This, in turn, may influence others to emulate it and its policies hence negating the necessity for expensive hard power expenditures.

Soft power is compared to hard power, which has traditionally been the predominant measure of national power, through quantitative means such as population size, military capabilities, geographic size, or a nation's gross domestic product or other economic factors. Although not as easily measured quantitatively, the extent of attraction can be measured by public opinion polls, by elite interviews, and case studies. Professor Nye argues that soft power

⁸⁹ Joseph Nye, Jr., *Soft Power: The Means to Success in World Politics* (New York: Public Affairs, 2004), X-XI.

is more than influence, since influence may also depend on the hard power of threats or payments. Plus, soft power is more than just persuasion or the ability to move people by argument, though that is an important part of it. It is also the ability to attract, and attraction often leads to acquiescence, support, and acceptance of policies, programs, and objectives.

Soft power is not the solitary possession of any one country or actor. In international affairs, soft power is generated in part by what the government does through its foreign policies and public diplomacy. However, the generation of soft power is also affected in both positive and negative ways by a myriad of non-state actors within and outside the country. Those actors affect both the general public and governing elites in other states, either creating a permissive or, conversely, a restrictive environment for government policies and objectives. Non-state actors certainly can include businesses or companies abroad. In some cases, soft power will enhance the probability of social, economic, or political elites adopting or mimicking policies that allow a foreign government to achieve preferred outcomes in another state. In other cases, where being perceived as too friendly to another country or government can be seen as a local political handicap, the decline or absence of soft power may prevent a government from obtaining particular goals.

Many external observers view China's application of soft power as part of a grand strategy aimed at convincing the world of Beijing's peaceful intentions, securing the resources it needs to continue its exponential economic growth, and isolating Taiwan in the international community. Concurrent with growth of economic and military capabilities, Chinese strategists have concluded that the development of soft power is a critical component of attaining these long-term strategic objectives. Generally speaking, Chinese strategists assert that the utility of soft power lies in its ability to foster an external environment conducive to China's rise. Chinese writers prolifically describe their country's grand strategy with references to a "peaceful rise," "peaceful development," or the building of a "harmonious world." The Central Party School has identified three stages in the process of China's rise:

1. By 2010, establish a "leading position" in East Asia, symbolized by the opening of the China-ASEAN free trade zone on January 1, 2010.
2. By 2020, attain a leading role as a "quasi-world power" in the larger Asia-Pacific region.

3. By 2050, to develop into a "world-level power."⁹⁰

Reaching these stages is inextricably linked to the growth of China's "comprehensive national power" (CNP). CNP was developed in the 1980s as an analytical framework through which progress in China's overall power position could be tracked and measured against other states. Broadly, CNP was calculated using tangible metrics including natural resources, economic growth, military capabilities, and social development. However, in the early 2000s, analysts added soft power as an abstract component of the overall CNP calculation.⁹¹

On October 15, 2007, Chinese President Hu Jintao publicly informed the 17th Chinese Communist Party Congress that China needed to increase its soft power.⁹² This professed need to increase its soft power has been realized via the establishment of Confucius Institutes, the launching of foreign language CCTV broadcasts, a Ministry of National Defense press center, and other mechanisms. Clearly, Chinese growing commercial presence abroad is also an actor in this expansion of soft power. In fact, China's growing ability to affect the actions of state actors largely stems from its role as a major source of foreign aid, trade, and investment.⁹³

It can be postulated that China garners significant soft power advantages, particularly vis-a-vis the U.S., Japan, and the European Union, because much of its foreign investments are carried out by SOEs. By Western standards, these state-owned enterprises lack public transparency, have massive financial resources backed by Beijing, and operate without many of the limitations that corporations with shareholders do. Chinese SOEs also have the added advantage of longer-term time horizons integrated with national priorities as they often do not have to show short term financial profits. In fact, SOEs historically have not routinely paid dividends to their largely state controlled shareholders.⁹⁴

Chinese increased commercial activities abroad have certainly played a role in its soft power expansion. Many Chinese companies started their going global strategy by entering the markets of the developing countries of the Third World. This market entry strategy was, in part,

⁹⁰ Joel Wuthnow, "The Concept of Soft Power in China's Strategic Discourse," *Issues & Studies*, June 2008, 5-6.

⁹¹ Wuthnow, "The Concept of Soft Power in China's Strategic Discourse," 6.

⁹² Richard Rosecrance and Gu Guoliang, *Power and Restraint* (New York: Public Affairs, 2009), 28.

⁹³ Congressional Research Service Report, *China's "Soft Power" in Southeast Asia*, report prepared by Thomas Lum, Wayne M. Morrison, and Bruce Vaughn, January 4, 2008, 1.

⁹⁴ Dumbaugh, *China's Foreign Policy: What Does it Mean for U.S. Global Interests?*, 13.

driven by risk mitigation of avoiding already saturated with Western products and focused on their competitive advantage of low cost. Chinese brands cannot yet match the iconic global stature of Coca-Cola, Microsoft, or McDonald's. The five Chinese players whose name recognition is beginning to garner some attention are PC maker Lenovo, brewer Tsingtao, appliance maker Haier, network giant Huawei, and car maker Chery.⁹⁵ Yet, some Chinese consumer goods companies' products in the developing world have become accepted and even desired by local populations. Part of the allure of Chinese products is the relatively low cost, particularly when compared to similar products from the West. In fact, affordable Chinese products have given consumers in the developing world access to goods that would have otherwise been outside their reach. In places such as Africa and the Middle East, ordinary citizens would have never been able to afford televisions, refrigerators, or air conditioners until Chinese companies such as Haier, Galanz, and TCL focused their efforts on these parts of the world. For example, Chinese-made Tiger generators are prevalent in Liberia because of the low cost whereas more expensive western brands can only be found with international aid agencies and diplomatic missions. By making items for ordinary people, China "will take control of the heart of the common people of Africa soon."⁹⁶

The same applies to the affect on the local telecommunications infrastructure of many developing countries. Huawei and ZTE brought reliable communications networks, particularly cell phone service, to remote parts of the developing world. Many countries in the developing world skipped the extensive use of landlines and leapfrogged to widespread cell phone usage.

Thus, in many parts of the developing world, Chinese companies are viewed favorably by local populations as offering products and services previously unavailable because western companies had ignored these markets. It can be inferred that this has engendered good will toward these companies and maybe towards China in general. Such public attitudes can be clearly interpreted as an example of generating soft power. Public opinion polls demonstrate that China's popularity remains high in most developing areas, whether in Southeast Asia, Africa, or Latin America, largely because of perceived economic benefits from engagement with China.

⁹⁵ Dexter Roberts, "How to Beat Made-in-China," *BusinessWeek Online*, October 9, 2007, http://www.businessweek.com/globalbiz/content/oct2007/gb2007108_553610.htm.

⁹⁶ William Foreman, "China's Influence Spreads Around World," *Yahoo News*, September 1, 2007, http://news.yahoo.com/s/ap/20070901/ap_on_re_as/china_global_impact.

Similarly, governments in the developing world have been influenced by China's corporate soft power as well. Whereas U.S. firms must contend with legal restrictions passed by the U.S. Congress such as Foreign Corrupt Practices Act as well as various economic sanctions enforced by the U.S. government, Chinese companies do not have such impediments to conducting business overseas. This has allowed Chinese companies to flourish in markets that have been eschewed by U.S. and European companies particularly in some pariah states such as Zimbabwe, Sudan, and Burma. The governments in such countries naturally appreciate the fact that China encourages its companies to operate in their territories without political preconditions.

The same applies to the various trade deals that the government Beijing sponsors. Chinese influence abroad is generally viewed as more benign. Chinese investments are not accompanied by political preconditions often demanded by the Americans and Europeans. Generally, Chinese assistance only has two pre-conditions: no diplomatic relations with Taiwan and general support for Beijing in international organizations. The Chinese government has negotiated more than 400 trade and investment deals with Latin American countries in the last few years, investing more than \$50 billion in the region. China has paid particular attention to nations with large oil and natural gas reserves, such as Venezuela, Kazakhstan and Nigeria. Beijing has forgiven more than U.S.\$1 billion in loans to African nations and indulged them with infrastructure projects. In countries in which it has made substantial energy investments, such as Sudan, Angola, and Equatorial Guinea, Chinese oil companies are accompanied by construction companies sent to develop the local infrastructure. Thus, while U.S. and European soft-power efforts are focused on democracy promotion and encouraging good governance abroad, China furthers its soft power agenda through lucrative trade and energy deals and produces tangible results like newly-built roads, stadiums, hospitals, and schools.

The global financial crisis will leave China in a relatively stronger position compared to the United States and Europe. Whereas the West has had to cut much of its overseas investments in recent years due to economic woes at home, China has been in a unique position to actually expand investment abroad. Moreover, Beijing has been able to make key investments in natural resources in the developing world while the West could not.

As was originally outlined, soft power can also be negatively impacted. In the developed world, China's corporate reputation has a spotty record indeed. Chinese products are derisively referred to in most of Europe and in North America. Placards encouraging Italians not to buy shoddy Chinese products were visible throughout Rome during the Christmas holiday season in 2010.⁹⁷ Countless episodes such as poisoned dog food, toys with lead paint, tainted toothpaste, and other embarrassing and dangerous exports have stained "Made in China" brands. It was reported that in Bolivia, vendors actually peel off or paint over "Made in China" labels.⁹⁸

Even in those countries of the developing world with more positive attitudes toward China, problems have arisen. Stories abound in the local media about a backlash within African populations against low-grade Chinese goods unfairly competing against and replacing African goods in local markets, Chinese labor being imported instead of using local labor for infrastructure projects, Chinese investors' disinterest in local environmental standards, and charges of Chinese neocolonialism and mercantile policies due to extraction of resources rather than investment in industry.

In neighboring Asian states, China's image has also taken a beating in the corporate arena. Shanghai Automotive Industry Corporation (SAIC), China's biggest car manufacturer, purchased a controlling stake in South Korea's Ssangyong Motors in 2004.⁹⁹ At the time, it was the most ambitious overseas acquisition for the Chinese automotive industry. Five short years later, the arrangement was in tatters as Ssangyong filed for bankruptcy. The South Koreans, rightly or wrongly, blamed this ending on the Chinese parent company. SAIC was vilified as an exploitative owner who did not fulfill its promises and whose sole interest was in acquiring South Korean technology. Coupled with a similarly acrimonious break-up between the Chinese BOE Technology Group and the South Korean Hydis, both electronics companies, South Korean public opinion has soured on Chinese corporations vying for South Korean firms.¹⁰⁰

In the U.S., the indications for China's soft power are not favorable. A 2010 poll by Columbia University found that 45% of American responded that Chinese investment in the

⁹⁷ The author was residing in Rome at the time and observed many of these placards.

⁹⁸ William Foreman, "China's Influence Spreads Around World," *Yahoo News*, September 1, 2007, http://news.yahoo.com/s/ap/20070901/ap_on_re_as/china_global_impact.

⁹⁹ The Chinese government switched the initially planned buyer of Ssangyong from BlueStar Chemical to SAIC.

¹⁰⁰ Choe Sang-Hun, "Soured Deal Embitters Shanghai and Seoul," *International Herald Tribune*, February 25, 2009, 1&12.

United States was not good for the economy. Despite an increase of 360% in Chinese investment in the U.S. in the first six months of 2010 arguably bringing with it jobs for Americans, the perception remains that China is a competitor state.¹⁰¹

The Chinese government is clearly concerned about such trends and the impact they are having on its soft power strategy around the world. Chinese Vice Premier Wang Qishan even publicly berated the head of Sany Heavy Industry Limited Company, a major engineering firm active in developing countries, for not being sensitive enough to cultural differences.¹⁰² In continuing its going global policy of actively encouraging and facilitating Chinese commercial activities overseas, the Chinese government in August 2006 promulgated new regulations demanding companies pay attention to issues of corporate responsibility and what it termed localization such as respect for local customs, safety standards, the environment, and labor. This underscores that Beijing takes the soft power implications of Chinese companies abroad seriously.

Despite, or in some non-democratic countries because of, China's authoritarian political system, the success of its economy in tripling gross domestic product over the past three decades has made it attractive to many developing countries. This has a direct correlation with China's soft power and was particularly reinforced by the 2008 financial crisis. In parts of Asia, Africa, and Latin America, the so-called "Beijing Consensus" development model consisting of authoritarian government coupled with a market economy has become more popular than the previously dominant "Washington Consensus" of market economics with democratic government.

¹⁰¹ Sheridan Prasso, "U.S. to China: Nimby," *Fortune*, September 6, 2010, 22.

¹⁰² Alan Wheatley, "China Inc's Global Growing Pains," January 21, 2010, <http://www.reuters.com/article/idUSTRE60J1RO20100121>.

Chapter 6 - Hard Power Implications of Chinese Companies Going Global

The principles comprising the concept of hard power have long been cited by political thinkers throughout history. Niccolo Machiavelli focused on the military aspects of power in *Il Principe* in 1532. Thomas Hobbes expanded the concept of power to include financial and economic means in *Leviathan* in 1651. Chinese thinkers such as Confucius, Mencius, and Sun Zi all included hard power concepts in their writings. In the last century, Hans Morgenthau and Henry Kissinger famously offered descriptions of state power in terms of hard power. In recent years, Chinese geo-political strategists such as Yan Xuetong have also written about China's growing influence and ways in which China can bring its power to bear.

Concepts of hard and soft power can be considered as two poles on the spectrum of power. Hard power is a theory that describes using military and economic means to influence the behavior or interests of other political bodies. The theory has its origin in the neo-realist school of international relations thought. It is based on the assumption that dominant economic resources and military capabilities can be equated with the ability of a state to influence other states neighbors. Neo-realists emphasize the hard power capacities of states, especially their military capabilities and economic strength as well as the size of their populations or the natural resources that they possess. Neo-realism emphasizes the capacity of states to influence others to behave as in ways the state wants them to behave. Hard power entails tangible, definable assets that can be used to enforce national priorities and further national interests often resulting in confrontational policies vis-à-vis other states. Thus, hard power is usually more readily recognizable than soft power.

Commensurate with its historically unprecedented growth in GDP, potential instruments of China's hard power have risen correspondingly. A leading economic observer of China, Jing Ulrich, stated that "China has a wall of money – a tsunami, really—that is about to hit the rest of the world."¹⁰³ In economic terms alone, the figures clearly demonstrate hard power:

¹⁰³ Bill Powell, "Enter the Dragon," *Time.com*, July 26, 2007, <http://www.time.com/time/magazine/article/0,9171,1647240,00.html>.

- Beijing is the largest holder of U.S. treasuries with over U.S.\$700 billion held in late 2008.¹⁰⁴
- Beijing's total foreign exchange reserves reached U.S.\$2.4 trillion in June 2010, the largest in the world.¹⁰⁵
- Since the Chinese government's announcement in 1999 promoting Chinese companies' activities abroad, ODI has surpassed U.S.\$178 billion.¹⁰⁶
- China's trade surplus doubled to U.S.\$20 billion in 2010.¹⁰⁷
- China established a sovereign wealth fund, the China Investment Corporation (CIC), with an initial seed of U.S.\$200 billion in 2007.¹⁰⁸ CIC supposedly had U.S.\$300 billion at its disposal in early 2010.¹⁰⁹

China's large holdings of U.S. securities, including U.S. public debt in the form of treasuries, has caused trepidation in the U.S. Some have expressed that China is doing this as leverage against U.S. policies that Beijing opposes.¹¹⁰ For example, various Chinese government officials are reported to have suggested that China could dump (or threaten to dump) a large share of its holdings to prevent the United States from implementing trade sanctions against China. Some Chinese military officers were quoted in early 2010 as recommending that China sell off its U.S. treasuries in retaliation for U.S. arms sales to Taiwan. Some worry that attempts by China to unload a large share of its U.S. securities holdings could have a significant negative impact on the U.S. economy, particularly if such a move triggered a sharp depreciation of the dollar in international markets and induced other foreign investors to sell off their U.S. holdings as well. In order to keep or attract that investment back, U.S. interest rates would rise, which would dampen U.S. economic growth.¹¹¹

In fact, many observers have concluded that China's strong economic and financial situation has led to abandoning Deng's dictum of "hide our capabilities and bide our time, and never try to take the lead." Instead, the Chinese government has seen an opportunity to assert

¹⁰⁴ Scissors, "Deng Undone," 25

¹⁰⁵ Ashley Tellis, Andrew Marble, and Travis Tanner, "Asia's Rising Power and America's Continued Purpose," *Strategic Asia 2010-11*, 2010, 44

¹⁰⁶ Jakobson and Knox, "New Foreign Policy Actors in China," 26.

¹⁰⁷ Tellis, Marble, and Tanner, "Asia's Rising Power and America's Continued Purpose," 44

¹⁰⁸ Pieter Bottelier, "China's Sovereign Wealth Fund," *CSIS Freeman Report*, January 2008, 1.

¹⁰⁹ Daniel Ren, "China on Buying Spree of US Stocks," *South China Morning Post*, February 10, 2010, B1.

¹¹⁰ Congressional Research Service, "China's Holdings of U.S. Securities: Implications for the U.S. Economy," report prepared by Wayne M. Morrison, January 9, 2008.

¹¹¹ Many analysts recognize that if China dumps its U.S. treasuries, it will do as much damage to its own economy as to that of the United States.

itself in the wake of the global financial crisis. In exchange for a greater role in the International Monetary Fund (IMF), China has promised to buy more IMF bonds to support it. China has called for the creation of another reserve currency to replace the U.S. dollar.¹¹² It is now abundantly clear that China is prepared to take an active and interventionist role in international financial affairs.

China's relatively deep pockets have buttressed its more assertive role in the IMF, the World Bank, the Asian Development Bank, and other global and regional entities. Chinese initiatives, such as Friendship and Cooperative Partnership Agreements, Free Trade Agreements, and Strategic Partnership Agreements, have solidified bilateral relationships. China has sought to devise new multilateral organizations that showcase its leadership such as the East Asia Summit (EAS), the Shanghai Cooperation Organization (SCO), the Forum on China-Africa Cooperation Forum (FOCAC), and the China-Arab Cooperation Forum. Many of these agreements result in the foreign partner receiving Chinese assistance in the form of interest-free or concessional loans or debt forgiveness. For instance, China provided the Democratic Republic of Congo a U.S.\$ 9 billion loan package for infrastructure projects while this same country owes U.S.\$ 11 billion to various international organizations.¹¹³ China's contributions to these same international organizations remains relatively small given its new found leadership on the world stage. Moreover, China often extends aid packages that include not only loans but also trade and investment agreements, largely in the energy sector.¹¹⁴

China uses a combination of political and economic means to protect its trade and foster bilateral ties. As a result, economic relations are not carried out on a purely commercial basis. There is a substantial amount of overlap between Chinese development aid, investments, and business deals. Chinese financing and political backing are increasingly enabling Chinese firms to attain a dominant competitive position in the developing world.

China has coupled its massive purchasing power with government backed funds for overseas direct investments and economic assistance to develop supply lines and long-term contracts to ensure deliveries of needed industrial and consumer inputs for its export driven

¹¹² Joshua Kurlantzick, "China's Turn," *Time Magazine*, April 13, 2009, 52.

¹¹³ John Fox and Francois Godement, *A Power Audit of EU-China Relations* (London: European Council on Foreign Relations, 2009), 39.

¹¹⁴ Congressional Research Service, "Comparing Global Influence: China's and U.S. Diplomacy, Foreign Aid, Trade, and Investment in the Developing World," report prepared by Thomas Lum, August 15, 2008, 29.

economy. The overarching need to secure access to resources has led to an increasingly nationalistic and competitive approach to energy security. Part of the Chinese strategy in support of this is for the national oil companies to use their state-sponsored resources to gain access to key energy producing countries of the world regardless of the autocratic nature of the governments involved. China's commercial activities abroad have even been accused of being mercantilist and sowing the seeds for potential economic rivalries in the future. China's actions are frequently viewed as being in a competition with other countries for finite natural resources.¹¹⁵ Some commentators have even forecast that China's insatiable search for resources will endanger international security whether it be in Central Asia, the South China Sea, the Middle East, or Africa.¹¹⁶

The direct investment by China in Africa appears to be part of a strategy to strengthen its energy security. In 2007, China reportedly imported U.S.\$25 billion worth of crude oil from African countries. China also imported copper, iron ore, and other resources from Africa. These resources are all considered critical in maintaining the country's economic growth. Beijing would like to secure this supply through ownership and investment deals in order to avoid the price and supply uncertainty associated with buying such commodities on spot markets.

On the corporate level as well, clear signs of China's growing hard power are evident. In 2010, Sinopec and two other state-owned energy conglomerates, the State Grid and China National Petroleum, made it to the top 10 of Fortune Magazine's top 500 list. Sinopec ranks seventh on the list, followed by the State Grid, China's largest power grid operator. China National Petroleum Corporation is tenth on the list. A total of 46 Chinese companies were on the list in 2010.¹¹⁷

The nexus of Chinese commercial activities, Chinese resource requirements, and Chinese government foreign policies are increasingly clashing with Western, particularly U.S., interests in cases of trade with what might be considered odious regimes. Chinese SOEs have extensive resource holdings and interests in countries such as Angola, Congo, Burma, Sudan, and Zimbabwe. All of the aforementioned have human rights and good governance issues. While

¹¹⁵ Andrews-Speed and Vinogradov, "China's Involvement in Central Asian Petroleum," 391.

¹¹⁶ Hongyi Harry Lai, "China's Oil Diplomacy: Is it a Global Security Threat?" *Third World Quarterly*, 28, no.3, 2007, 520.

¹¹⁷ Fortune Global 500, July 26, 2010, <http://money.cnn.com/magazines/fortune/global500/2010/countries/China.html>.

the West routinely uses economics and business in attempts to bring pressure to bear on these regimes, China largely refuses to exert its economic muscle for political ends.

While much of the international community is trying to isolate Iran primarily through economic means to stifle its illicit nuclear program, Chinese commercial interaction with Iran is growing. As Iran's trade with the European Union has declined in recent years, Sino-Iranian trade has increased inversely. In April 2008, Iran was the second largest supplier of oil to China. The same Sinopec that is on the 2010 Fortune top 10 list agreed in December 2007 to a U.S.\$2 billion investment agreement to develop the Yadavaran oil field in southwestern Iran. The overall purchase agreement was over U.S.\$100 billion. CNOOC, number 252 on Fortune's top 500 in 2010, agreed to a U.S.\$16 billion investment to develop Iran's North Pars gas field in 2008. The spokesman for the Chinese Ministry of Foreign Affairs (MFA) characterized the reported CNOOC deal as "nothing beyond a business deal between relevant enterprises," and argued that with regard to international nonproliferation efforts, "actions against Iran should not affect or impair normal economic and energy cooperation with Iran." Speaking in China in April 2008, Iran's Deputy Foreign Minister for Economic Affairs argued that, "Iran and China must cooperate more closely with one another and to consider it a duty to ward off the negative effects of third country's influence in their economic relations."¹¹⁸ Chinese firms remain involved in a wide variety of ventures in Iran including infrastructure construction projects involving highways, industrial facilities, the Tehran metro system, and airport construction. The aforementioned example appears to be a clear example of China's economic and commercial prowess buttressing the Iranian government in the face of widespread international efforts to prevent further development of its uranium enrichment technology.

China has major investments in oil and gas projects in Burma. In the wake of the Burmese military junta's crackdown on Buddhist monk led protests in September 2007, China blocked a strong United Nations (UN) resolution. It finally supported a much weaker resolution.

Sinopec signed a memorandum of understanding with Saudi Aramco in 2006 for Saudi Aramco to provide 1 million barrels per day (BPD) to Sinopec and its affiliates by 2010. In

¹¹⁸ Congressional Research Service, "Comparing Global Influence: China's and U.S. Diplomacy, Foreign Aid, Trade, and Investment in the Developing World," report prepared by Thomas Lum, August 15, 2008, 149.

2009, China surpassed the U.S. as Saudi Arabia's biggest customer for oil. The amount of Saudi crude oil that China imported exceeded 1 million barrels per day, while the U.S., the primary importer of the country's oil before, imported less than 1 million barrels per day for the first time since more than 20 years. China's strong demand for oil backed by robust financial resources is changing the structure of the global oil market. Saudi Arabia has been one of the most important sources for U.S. oil imports, but in 2009, the imports amount dropped dramatically, while China's imports amount grew 15.1% to replace the U.S. as Saudi Arabia's largest customer. Some observers have characterized Saudi Arabia's change in the oil flow direction to indicate subtle changes in the global oil market.¹¹⁹ Additionally, Sinopec has drilled for natural gas in Saudi Arabia's Empty Quarter.

China established its sovereign wealth fund, the China Investment Corporation (CIC) on September 29, 2007.¹²⁰ Initially with approximately U.S.\$200 billion of assets under management, CIC's assets have grown to \$332 billion by the end of 2009. CIC was established in order to utilize these reserves for the benefit of the state, modeled on Singapore's Temasek Holdings. The state-owned Central Huijin Investment Corporation was merged into the new company as a wholly-owned subsidiary company. CIC's management and board of directors report to the State Council of the People's Republic of China; the equivalent of the national cabinet. Lou Jiwei is the Chairman and Chief Executive Officer (CEO) of CIC as well as a deputy secretary of the State Council.¹²¹ CIC is generally viewed as being firmly entrenched in the political establishment because it falls under as the authority of Chinese Premier Wen Jiabao and the composition of its board of directors is practically determined by China's Ministry of Finance.

China's sovereign wealth fund could potentially give Beijing another instrument to project its power around the world.¹²² Skeptics, particularly in the U.S. Congress, want to know what would happen if China was to systematically acquire significant holdings in sensitive industries such as telecommunications, energy and defense. The main concern is whether

¹¹⁹ "China exceeds US to become Saudi Arabia's top oil customer," *Global Times*, February 23, 2010, <http://business.globaltimes.cn/china-economy/2010-02/507404.html>.

¹²⁰ Bottelier, "China's Sovereign Wealth Fund," 1.

¹²¹ Bottelier, "China's Sovereign Wealth Fund," 1.

¹²² Lum, "Comparing Global Influence: China's and U.S. Diplomacy, Foreign Aid, Trade, and Investment in the Developing World," 72.

investments by sovereign wealth funds, in this case CIC, could entail security risks because of ulterior motives of the government which controls the fund. Theoretically, CIC could purchase control over key industries and or access to important natural resources. Some speculate that China could acquire several major U.S. companies and obtain the power to unduly influence the U.S. economy or that of any other country in a similar fashion. Others conjecture that China might use the CIC to obtain market power over key natural resources or access to sensitive technology by purchasing a seat on a corporation's board of directors.

Most international observers do not believe that the Chinese State Council established the CIC with the explicit intent to wield it as an instrument of power. Yet, it is conceivable now that CIC is in operation, that the State Council could opt to leverage it as a means of advancing China's foreign policy objectives. One possible indication that Chinese officials recognized CIC's power potential was their pattern of pointing out, in recent years, that the investments of sovereign wealth funds in ailing foreign financial companies were providing stability to the market during a period in which there was growing concern about the global financial crisis. In December 2007, CIC invested U.S.\$5 billion in Morgan Stanley.¹²³ CIC's purchase of Morgan Stanley shares at a time when the firm was struggling was viewed as opportunistic by some.¹²⁴

At the time, the CIC purchase of Morgan Stanley deal just one example of Chinese government funds investing heavily in overseas equities. In April 2008, the State Administration for Foreign Exchange (SAFE) spent U.S.\$2 billion to acquire a small stake in the British Petroleum (BP). Earlier that same month, SAFE invested U.S.\$2.45 billion in the French oil company Total.¹²⁵

Perceptions, or misperceptions, of the connection between Chinese corporations and Chinese national hard power have also resulted in some very public setbacks to Chinese ODI efforts. Perhaps the most well-known example was CNOOC's failed purchase attempt of Unocal, the ninth largest oil company in the world at the time. China National Offshore Oil Corporation, on June 23, 2005, made an unsolicited, all-cash bid of U.S.\$18.5 billion for the California based Unocal. The bid by CNOOC was noteworthy because Unocal had already

¹²³ Rick Carew, "Morgan Stanley receives \$5 billion in China Funds," *The Wall Street Journal Asia*, December 20, 2007, A1.

¹²⁴ The CIC investment in Morgan Stanley actually ended up being a poor investment as the value fell to US\$1.77 billion by early 2010.

¹²⁵ Rick Carew, "China Gambles on Big Overseas Plays," *The Wall Street Journal*, April 16, 2008, C2.

agreed, on April 4, to be acquired by Chevron for U.S.\$16.5 billion in cash and stock. CNOOC's move triggered a political furor that reflected the United States' concerns about the China's increasing financial influence and its bustling economy's growing appetite for overseas oil. As a state-owned company, CNOOC represented a major business enterprise operating under Chinese government auspices with access to the vast resources of China proposing to purchase a large company with potentially strategic significance to the United States. The fact that CNOOC offered to pay a premium for Unocal was also noteworthy because it revealed the uniquely Chinese characteristic of wanting captive supply sources. Many U.S. politicians also expressed concern about Unocal's oil drilling having military applications that could some day be used against the United States. On June 30, the U.S. House of Representatives approved a resolution declaring that CNOOC's proposed acquisition could threaten America's national security and warranted a thorough investigation. In the face of unprecedented opposition, CNOOC withdrew its bid in early August.¹²⁶

Another instance of failed Chinese ODI in the U.S. was the 2008 attempt of Shenzhen based Huawei Technologies, the network telecommunications equipment maker, to buy 3COM Corporation in 2008. In an apparent nod towards U.S. sensitivities, Huawei together with a U.S. partner proposed a U.S.\$2.2 billion deal to acquire 3Com. The case made headlines because 3Com makes computer network security equipment for the U.S. military and Huawei Technologies has ties to the Chinese military. Ren Zhengfei, Huawei's founder and chairman, is a former PLA officer. The concern was that Huawei would be able to alter the electronic equipment and computer software sold to the U.S. military in a way that could make it vulnerable to future exploitation. On the U.S. Capitol Hill, the deal was referred to as "a stealth assault on America's national security."¹²⁷ The U.S. Treasury Department's Committee on Foreign Investment in the United States (CFIUS) investigated the potential national security risks of the deal.¹²⁸ Ultimately, this deal also failed due to the extreme public and political scrutiny in the U.S.

¹²⁶ Ben White, "Chinese Drop Bid To Buy U.S. Oil Firm," *Washington Post*, August 3, 2005, <http://www.washingtonpost.com/wp-dyn/content/article/2005/08/02/AR2005080200404.html>.

¹²⁷ Andrew Parker and Paul Taylor, "Huawei Rails at Security Concerns over 3Com Deal," *Financial Times*, February 12, 2008, 24.

¹²⁸ Steven R. Weisman, "Sale of 3Com to Huawei is derailed by U.S. security concerns," *New York Times*, February 21, 2008, <http://www.nytimes.com/2008/02/21/business/worldbusiness/21iht-3com.1.10258216.html>.

Perhaps the most compelling example of possible nefarious Chinese government involvement in commercial activities involved the Aluminum Corporation of China (Chinalco) in the Anglo-Australian miner Rio Tinto. Chinalco's proposed investment of U.S.\$19 billion in Rio Tinto in 2009 caused a flurry of questions about a Chinese state-owned enterprise buying a strategic asset abroad. Reactions were critical due to Chinalco's previous role as one of Rio Tinto's biggest customers. It was argued that Chinalco's fundamental objective in trying to acquire the 18% stake in Rio Tinto was to break the virtual monopoly enjoyed by Rio Tinto and two other companies have on global pricing for iron ore and other key commodities that China desperately needs.¹²⁹ Australian politicians condemned China's SOEs as "nothing more than an arm of the Communist Party. Public and private voices in Australia questioned whether Chinese investments would be motivated purely by commercial interests. In this specific case, there was considerable concern that a potential conflict of interest could arise over pricing strategies in this key resource sector.¹³⁰ Australia would want to maximize prices as a producer while China would want the exact opposite as a consumer. In the face of shareholder and political opposition, this deal failed in June 2009. Beijing was outraged at Rio walking away from the Chinalco investment which came against the backdrop of contentious iron-ore pricing negotiations between Rio and China's major steelmakers. In July, Chinese authorities arrested four Rio Tinto executives, in what many observers characterized as retaliation. This particular episode underscored for international skeptics the potential role of the Chinese government in commercial transactions involving ODI and the risks involved in crossing a potential Chinese SOE and its hard power consequences.

¹²⁹ Bill Powell, "Rio Tinto – China Strikes Back," *Fortune*, August 24, 2009, http://money.cnn.com/2009/08/24/news/companies/china_rio_tinto.fortune/index.htm.

¹³⁰ Mark Thirlwell, "Dealing with the Dragon: Australia and Chinese Inward Investment," *Clingendael Asia Studies*, April 1, 2010, 2.

Chapter 7 - Regional Reactions to Chinese Commercial Activities

Reaction to the growing presence of Chinese companies overseas has varied from country to country and from company to company. As some of the previously cited examples have demonstrated, international reactions have included a wholehearted welcoming of Chinese overseas direct investment to a disdain for any Chinese involvement to a fear of the Chinese government's black hand in Chinese companies' activities. Yet, what is indisputable is that Chinese companies offer an increasingly high level of financial resources available to foreign markets without many of the pre-conditions that Western predecessors in those same markets had demanded.

Like all investments emanating from a foreign source, Chinese ODI should bring employment, tax revenues, and reciprocal market access. In the West, it is also hoped that Chinese corporate presence abroad will expose those companies to standards of corporate governance and social responsibility that will ultimately find their way to China itself.

Africa

Official government reactions to Chinese ODI have been generally positive. As Senegalese President Abdoulaye Wade stated in January 2008, "China's approach to our needs is simply better adapted than the slow and sometimes patronizing post-colonial approach of European, investors, donor organizations, and non-governmental organizations."¹³¹ Chinese investment across the African continent has found cooperative hosts in countries whose governments have tired of perceived Western interference in domestic affairs. Sudan is the quintessential example of China's willingness to offer a broad based relationship consisting of aid, investment, and political protection free of international pressure on human rights.¹³²

However, local reactions of the people in African countries have not always mirrored governmental reactions. In 2007, a visit by Chinese President Hu Jintao to a Chinese owned copper mine in Zambia was canceled due to local miners rioting over harsh working

¹³¹ J. Ndumbe Anyu and J.-P. Afam Ifedi, "China's Ventures in Africa: Patterns, Prospects, and Implications for Africa's Development," *Mediterranean Quarterly* 19, no. 4, Fall 2008, 101.

¹³² Anyu and Ifedi, "China's Ventures in Africa: Patterns, Prospects, and Implications for Africa's Development," 99.

conditions.¹³³ The Chinese tendency towards cultural exclusivity and importing from home everything a Chinese project might need in Africa has created a backlash. Ample anecdotal evidence points to Chinese companies bringing in not only their own construction workers for infrastructure projects, but also other Chinese to create a quasi exclave of a tertiary economy in support of the original project. Dumping of Chinese goods and taking away local jobs has caused resentment, consternation, and even some protests and upheaval in countries such as Ghana, Angola, and Sierra Leone.¹³⁴ Moeletsi Mbeki, political commentator and brother of the former South African president, compared the trade of African natural resources for cheap Chinese manufactured goods to former colonial arrangements.¹³⁵

Americas

The Western Hemisphere has witnessed China's resource-focused diplomacy from investments in the Canadian oil sands of Alberta to Chinese participation in the oil sectors of Venezuela and Brazil. Official government reaction has always been positive and receptive to Chinese ODI. The growing commercial relationship between China and Latin America has even led the governments of Argentina, Brazil, Chile, Peru, and Venezuela to recognize China as a "market economy."¹³⁶

The general impression of Chinese products in Latin America is that they are cheap and of dubious quality. Yet, examples such as the Chinese Changhe brand cars on Ecuador's streets abound.¹³⁷ Chinese consumer companies are competing strictly on price in Latin America. On the one hand, there is the backlash based on poor quality goods. On the other hand, these same goods are providing some locals with the first opportunity to own a air conditioner, refrigerator, or even a car. This contradiction has both positive and negative soft power implications.

Most of the U.S. media's coverage of Chinese ODI has focused on the potential security implications of Chinese companies buying U.S. assets. Yet, there is little indication of any anti-Chinese resentment in communities across the U.S. looking for new employers. The appliance

¹³³ Alan Wheatley, "China Inc's Global Growing Pains," January 21, 2010, Available at <http://www.reuters.com/article/idUSTRE60J1RO20100121>, Accessed; 23 December 2010.

¹³⁴ Meetings at Headquarters, U.S. Army Africa, Vicenza, Italy, 5 January 2011.

¹³⁵ William Foreman, "China's Influence Spreads Around World," *Yahoo News*, September 1, 2007, http://news.yahoo.com/s/ap/20070901/ap_on_re_as/china_global_impact.

¹³⁶ Marco Rossi, "L'economia Cinese Si Proietta Verso L'estero," *ISPI – Relazioni Internazionali*, February 2005, 24

¹³⁷ Simon Rabinovitch, "China Carmakers follow Template, They use Emerging Markets as Testing Ground for Big Leagues," *International Herald Tribune*, April 22, 2008, 4.

maker Haier was the first Chinese company to build a factory in the U.S. in 2000.¹³⁸ Since then, there has been a considerable action to attract Chinese investment to the U.S. Some 33 American states, cities, and ports have sent delegations to China to offer incentives for Chinese manufacturers to move operations to their locations. Such action has resulted in the pending completion of the largest-ever Chinese factory in the U.S. Tianjin Pipe Group in Corpus Christi, Texas made an initial investment of U.S.\$1 billion for the plant that will employ 600 Texans by 2012.¹³⁹

Asia

Most of China's initial ODI forays were in Asia. The concept was to focus on areas that were geographically close and ethnically and linguistically similar. In the initial stages during the years 1979-1994, 67% of all Chinese ODI and 56% of all investment projects was in Hong Kong, Macao, and other Asian neighbors.¹⁴⁰ Chinese companies in the emerging markets of Asia were competitive as they addressed the demand for cheaper, but good enough products. Chinese ODI has expanded since the early days. One constant remains and that is that Asia remains the top destination for Chinese ODI.

In Southeast Asia, Chinese companies not only look to acquire raw materials to feed China's economy, but they are increasingly investing in other ways. Locals often focus on China attracting billions of inward FDI dollars every year which, in a previous era, may have been earmarked for Southeast Asia. Yet, the flipside of the investment in China is that the growth of the Chinese economy has also resulted in a wave of Chinese ODI, particularly into neighboring countries. In some cases, Chinese investment has resulted in considerable backlash. For instance, China is practically the lone supporter of the Burmese military junta.

Chinese investment is critically important to the Burmese regime. Beijing has invested some U.S.\$8 billion in gas, oil and hydroelectric ventures in Burma in 2010 alone.¹⁴¹ China has been regularly criticized for its almost unconditional support for the Burmese government in

¹³⁸ Despite Haier's strong presence in the U.S., it still was not enough for it to be able to acquire Maytag in 2005.

¹³⁹ Sheridan Prasso, "American made...Chinese Owned," *Fortune*, May 24, 2010, 86-87.

¹⁴⁰ Zhan, "Transnationalization and Outward Investment: the case of Chinese Firms."

¹⁴¹ Sue Lloyd-Roberts, "Burma uses Chinese investment to harass opponents," *The Telegraph*, November 8, 2010, <http://www.telegraph.co.uk/news/worldnews/asia/burmamyanmar/8116199/Burma-uses-Chinese-investment-to-harass-opponents.html>.

exchange for access to natural resources and its port of Sittwe on the Indian Ocean.

Furthermore, China has developed a deep-water port at Kyaukpyu in the Bay of Bengal. China used a rare veto against a U.S. sponsored United Nations Security Council resolution targeting Burma's poor human rights record on January 12, 2007.¹⁴²

In Central Asia, Chinese investments are mainly in the oil and gas sectors as outlined earlier. China's reliance on outside sources for its energy needs have raised its profile in this region. Its leadership in the Shanghai Cooperation Organization (SCO) is heavily influenced not only because of security and political imperatives, but also by economic and specifically energy requirements.¹⁴³ Chinese companies in these sectors have faced criticism because of the preponderance of Chinese laborers working on local projects instead of hiring indigenous employees. Yet, host-nation governments have responded generally favorably to Chinese investments in their efforts to secure export routes for their petroleum. In fact, China has been viewed favorably, particularly by the Kazakh and Turkmen governments, as it relieves their dependence on Russia for transit.¹⁴⁴

Chinese ODI in Northeast Asia has also been growing despite many challenges. Failed Chinese bought companies in South Korea, as previously described, have resulted in a South Korean perception of Chinese predatory business practices. Some observers believe that China is cherry-picking Korean high tech companies and not interested in long-term mutually beneficial relationships. In Japan, many companies acknowledge needing to expand in China to survive commercially and believe that receiving capital investment from a Chinese company could confer an advantage. The global financial crisis has dried up Western and Japanese capital providing Chinese companies an opportunity to make Japanese acquisitions. However, the local consensus opinion remains that Japanese companies would prefer to be acquired by a local company over a Western one, and only then a Chinese company as a distant third option.¹⁴⁵

¹⁴² Dumbaugh, *China's Foreign Policy: What Does it Mean for U.S. Global Interests?*, 17. This was only the 5th time that China exercised its veto authority in the Security Council.

¹⁴³ Rossi, "L'economia Cinese Si Proetta Verso L'estero," 23.

¹⁴⁴ Andrews-Speed and Vinogradov, "China's Involvement in Central Asian Petroleum," 396.

¹⁴⁵ Michiyo Nakamoto, "China Investment: Big Neighbour Seeks Expertise and Technology," *Financial Times*, September 7., 2010, <http://www.ft.com/cms/s/0/aaf3e310-b94b-11df-99be-00144feabdc0.html#axzz1AReITGDj>.

Europe

Chinese economic growth is seen as a double edged sword by many European observers. China's huge potential market is courted by all, but particularly by the Germans, until recently the world's biggest exporter (until they were surpassed by China in 2009). Chinese companies slowly entered the lower end of the European market. Gradually, they became visible in high tech fields such as electronics including communications and computers. The Chinese TCL bought Germany's Schneider Electronics in 2002 and France's Thomson Electronics' television operations in 2003.¹⁴⁶ However, the TCL-Thomson deal failed by 2006 when TCL decided to shut down its European manufacturing unit after failing to stem losses.¹⁴⁷ Moreover, TCL also acquired a majority stake in the French Alcatel's handset business which also failed.¹⁴⁸ Both failures did not inspire confidence in China's European acquisitions.

In recent years, Chinese companies have bought European automobile icons such as Rover and Volvo. Some believe that by 2020 Chinese made cars will represent 7% of the market in Europe.¹⁴⁹ Yet, safety concerns about Chinese cars made exceptionally bad headlines throughout Europe after dismal results in tests by organizations such as Stiftung Warentest and the ADAC in Germany.¹⁵⁰ Chinese acquisitions remain a growing trend in a variety of sectors even including examples such as a Chinese company's purchase of a French Bordeaux chateau.¹⁵¹

Yet, Chinese investment in the European Union remains relatively low, roughly equivalent to Chinese ODI in Australia alone. Initial European reaction to Chinese ODI is usually focused on the associated economic benefits. This has particularly been the case in regards to the construction and automobile industries. In the newer European Union states such as Hungary, Bulgaria, Slovakia, and Slovenia, the governments have directly and explicitly lobbied for Chinese investments.¹⁵²

¹⁴⁶ "China Spreads its Wings – Chinese Companies Go Global," <http://www.accenture.com/>.

¹⁴⁷ Winnie Pang, "Picture Imperfect," *The Standard*, November 6, 2006, http://www.thestandard.com.hk/news_detail.asp?we_cat=14&art_id=31046&sid=10724438&con_type=1&d_str=20061106.

¹⁴⁸ Alan Wheatley, "China Inc's Global Growing Pains," January 21, 2010, <http://www.reuters.com/article/idUSTRE60J1RO20100121>.

¹⁴⁹ "Hungrier Drache," *Focus Money*, May 2005, 7.

¹⁵⁰ Jim Gorzelany, "Shanghai Surprise," *Hemispheres*, April 2009, 70.

¹⁵¹ "Chinese Firm Purchases first Bordeaux Chateau," *China Daily*, January 31, 2008, 11.

¹⁵² Schueler-Zhou, Schueller, and Brod, "Chinas Going Global – Finanzmarktkrise bietet Chancen fuer chinesische Investoren im Ausland," 5-6.

Chinese financial strength has been viewed as a lifeline for troubled European economies such as Greece and Portugal as the Chinese government has provided assistance in tackling their very serious budget deficits.¹⁵³ These European governments have been grateful for the pseudo-Chinese bail out, but many observers are speculating what the quid pro quo will eventually be. The on-going debate on the EU arms embargo has been indirectly influenced by China's growing economic power.

Other challenges exist. Most Europeans consider China's one-party political system as autocratic and incompatible with their own democratic traditions and norms. Thus, China's growing commercial presence has caused some concern. A local observer stated that in Norway, for instance, there was great debate and controversy about a Chinese telecommunications company involved in domestic communications. Dutch commentators worried about continued Chinese investments in the port of Rotterdam given support for the Dalai Lama and ethnic Uighurs.¹⁵⁴ French observers viewed with apprehension the purchase of a former air base in Chateauroux that boasts a 3,500 meter runway by a Chinese consortium ostensibly for economic development purposes in 2010.¹⁵⁵

The EU does not have an investment review system such as the U.S. CFIUS. Some individual EU member states such as Germany, France, and the United Kingdom have mechanisms to review potential sensitive commercial acquisitions, but not on par with CFIUS. Calls have emerged for the EU as a whole to establish a system similar to CFIUS to consider the various implications of Chinese investments.

A unified European stance toward China is hampered by a division of policies between individual European states.¹⁵⁶ Despite the rhetoric and the theory, there really is no unified European foreign policy. In fact, some observers believe that China has successfully played individual European governments off of one another. There is not much focus on potential national security implications of Chinese commercial activities. However, there is a growing concern that the Chinese government may leverage its economic influence to undermine

¹⁵³ Tim Bartz and Doris Grass, "China macht Portugal Weihnachtsgeschenk," *Financial Times Deutschland*, December 23, 2010, 19.

¹⁵⁴ As told to author by Norwegian and Dutch nationals on September 8, 2010 at a conference at The Hague.

¹⁵⁵ Meeting at the Asia Centre in Paris, 25 February 2011.

¹⁵⁶ Meeting at the Asia Centre in Paris, 25 February 2011.

European calls for political change in China and improvements in human rights, religious freedom, and increased autonomy for Tibet and Xinjiang.

Middle East

Oil lies at the heart of the Sino-Middle Eastern relationship. China's economic growth has spurred the Middle Eastern economies. The rise of China has corresponded with a rise in global oil prices. China accounted for one third of the increase in global oil consumption between 2004 and 2007.¹⁵⁷ This has been well received by most of the oil exporting lands of the Middle East. Much of the Middle East views China as an alternate partner to the more politically fickle states of the West.

Chinese investments in the petroleum sector in the Middle East in such countries as Iran and Saudi Arabia have already been discussed. Additionally, in the first major oil deal Iraq has made with a foreign country since 2003, the Iraqi government and the China National Petroleum Corporation agreed to jointly develop the Ahdab oil field with a Chinese investment of U.S.\$3 billion.¹⁵⁸ China's pricing margins were so low that Western companies could not realistically compete. This was good news for Iraq, but not necessarily for the free market.

Some, but not all Middle Eastern states have been affected by the presence of cheap Chinese consumer imports. These cheap Chinese imports may result in local competitor factories closing in such countries as Egypt, known regionally as "the China of the Arab world" because of its history of a large labor pool.¹⁵⁹ Thus, Chinese investments may end up costing more jobs than they create in some local economies.

¹⁵⁷ Ben Simpfendorfer, *The New Silk Road* (New York: Palgrave Macmillan, 2009), 52.

¹⁵⁸ Erica Goode and Riyadh Mohammed, "Iraq Signs Oil Deal With China Worth Up to \$3 Billion," *New York Times*, August 28, 2008, <http://www.nytimes.com/2008/08/29/world/middleeast/29iraq.html>.

¹⁵⁹ Simpfendorfer, *The New Silk Road*, 113.

Chapter 8 - Implications for the United States

U.S.-China relations are regularly viewed through the prism of great-power politics, traditionally seen in terms of an unmitigated struggle for power among nation-states. Some mainstream international relations theories attribute inevitable great power conflict to the supreme value that states attach to superior relative power. It is from this perspective that China's economic growth and rise in power are viewed as detrimental by many foreign observers outside China. There is little agreement about the degree of threat or challenge China poses to the United States, if any. The argument is generally between those who view China as a growing military menace with malicious intent fueled by global economic expansion.

A frequent interpretation of China's rise is that it is inversely related to the standing of the U.S. in the world. Thus, Chinese ODI and its soft and hard power consequences are seen as being in a zero sum game with the U.S. equivalent. Certain aspects of this interpretation are true yet they do not provide a complete picture, as is often the case.

Domestic Implications

Some analysts have expressed concern over China's large holdings of U.S. securities, including Treasury securities, contending that China could use it as a political weapon against the United States. If China reduced its holdings of U.S. securities, they would be sold to other investors, who would require higher than prevailing interest rates to be enticed to buy them. Higher interest rates would cause a decline in investment spending and other interest-sensitive spending. A reduction in Chinese Treasury holdings would cause the overall foreign demand for U.S. assets to fall, and this would cause the dollar to depreciate. If the value of the dollar depreciated, the trade deficit would decline, as the price of U.S. exports would fall abroad, and the price of imports rose in the United States.

The probability that China would suddenly reduce its holdings of U.S. securities is unlikely because it would not be in China's economic interests to do so. A large sell-off of China's U.S. holdings would reduce the value of these securities in international markets, which would lead to large losses on the sale, and would, in turn, decrease the value of China's remaining dollar-denominated assets. This would also occur if the value of the dollar were greatly diminished in international currency markets due to a Chinese sell-off. Such a move

would diminish U.S. demand for Chinese imports, either through a rise in the value of the *renminbi* against the dollar or a reduction in U.S. economic growth. The export driven Chinese economy would thus be starved of its biggest customer, the United States.

The U.S. government has been increasingly concerned about Chinese companies' ties to the Chinese government and military. In 2010, U.S. lawmakers inserted a provision in the Senate's National Defense Authorization Act at the request of the Defense Department giving military agencies new power to force technology vendors to exclude subcontractors or suppliers deemed to be a potential security risk such as the Chinese companies Huawei and ZTE. There are fears that Chinese telecommunications equipment manufacturers are potentially subject to "significant influence by the Chinese military which may create an opportunity for manipulation of switches, routers, or software embedded in American telecommunications network so that communications can be disrupted, intercepted, tampered with, or purposely misrouted."¹⁶⁰

On the other hand, Chinese financial resources are able to provide economic assistance to communities across the U.S. by investing in new manufacturing facilities as was described in Chapter 7. In these communities, Chinese firms are creating jobs that may eventually give rise to a growing constituency of pro-China voices in the U.S.

International Implications

China has rapidly emerged as a peer competitor of the U.S. and a growing source of international influence, investment, and political and economic clout. Some observers view China as attempting to project soft power by portraying its own system as an alternative model for economic development that does not require compliance with western political standards. This is the so-called Beijing Consensus versus the Washington Consensus that was previously described. Economic development without the restrictions and demands that come with political liberalization has proven to be attractive to some authoritarian governments ruled by elites such as in Burma, Sudan, Venezuela, and Zimbabwe.

¹⁶⁰ Joann Lublin and Shayndi Raice, "Security Fears Kill Chinese Bid in U.S.," *Wall Street Journal*, November 5, 2010, <http://online.wsj.com/article/SB10001424052748704353504575596611547810220.html#ixzz19uOyvYZf>.

Beijing is seen to have advantages over the United States in that its overseas activities and investments are conducted by strong, well-funded, and well-connected state-owned enterprises. These large Chinese conglomerates connected to the Chinese government and the Chinese Communist Party garner significant international attention and give a hard edge to its soft power. The United States has little to match such centrally directed initiatives as U.S. companies are just not organized in the same manner and the U.S. government plays a much different role in the private sector.

However, the above does not take into account the massive advantage the United States has in the scope and scale of its substantial global private sector presence shaped over the past century. In addition to U.S. business interests, American products, schools, newspapers, journals, banks, movies, TV programs, novels, rock stars, medical institutions, politicians, Chambers of Commerce, state governments, religious groups, non-governmental organizations (NGOs), and other American institutions and values are liberally scattered over the global map.¹⁶¹ Although China's presence and influence has grown exponentially over the past several decades, it still pales in comparison to that of the U.S.

It may be presumptuous to conclude that China's growing economic influence internationally via its ODI is dangerous or negative. Chinese investments in some areas in terms of infrastructure improvements, improving living and health standards, and regional economic development serves the causes of international and regional stability. Moreover, Chinese economic influence with its commensurate political authority may eventually serve U.S. and Western interests. Despite overall international disappointment in what appears to be almost unconditional Chinese support for Iran and North Korea, the key role of Chinese SOEs in these two economies may ultimately lead to Beijing exerting pressure when their own threshold for these two rogue regimes' behavior becomes too great to bear.

Post-Mao China has evolved into a status quo power. Hence, Chinese interests appear to have benefitted by operating within the current global system, of which Washington has been the chief architect, than by challenging it. Therefore, many argue that China's rise is not necessarily negative for U.S. interests. Conversely, the rise of Germany and Japan in the last century has

¹⁶¹ Dumbaugh, *China's Foreign Policy: What Does it Mean for U.S. Global Interests?*, 16.

been deemed analogous to China's current rise. Therefore, cautionary notes for the U.S. abound pointing towards a hedging strategy particularly given China's sometime troubling international relationships with pariah states.

Regardless of the various interpretations of Chinese intent, its international engagement and growing economic clout demand foresight and planning on the part of U.S. policymakers. Specific issues that the U.S. inter-agency community must consider include:

- An amplification of U.S.-Chinese competition for leverage and influence in terms of international economic and corresponding political relationships.
- The affect of Chinese "no strings attached" investment and assistance on U.S. global efforts to promote good governance, the free market, human rights, and democracy.
- The impact of Chinese companies' perceived advantages vis-à-vis U.S. companies to compete for international business and available U.S. means to mitigate these unfair advantages.
- The implications for U.S. global objectives and for institutions that promote Western values, such as the IMF and the World Bank, given China's increased role as an international lender offering less encumbered assistance.
- An increase in U.S.-Chinese competition for energy resources.

U.S. Policy Recommendations

It would be futile as well as counterproductive to attempt to hinder, or even appear to want to hinder, Chinese continued commercial expansion abroad. It is an almost certainty that this trend will continue. As the world's second largest economy, China will have its share of companies engaged in business overseas. In fact, that number is destined to grow and will thus magnify the associated implications outlined above for the United States. Given this trend, it is prudent to adopt certain policies to address and mitigate, when and where warranted, the global expansion of Chinese influence via economic and commercial activities.

A realistic approach which leverages America's durable hard and soft power advantages, while not unnecessarily antagonizing China, is required. Some argue that China's relative rise

has been commensurate with America's relative decline. However, this oversimplification should not be equated to a foregone conclusion or a zero sum game. In many respects, the U.S. and Chinese economies are intrinsically linked and are dependent on one another for the continued growth of both economies. As China's leaders are realists, they are seeking benefits and advantages for their country. Thus, Chinese leaders should be made aware of the advantages associated with mutually beneficial policies as well as the potential costs of intransigence and uncooperative behavior. In essence, U.S. policy emphasis should be placed on actions that can influence, shape, and co-opt Chinese economic and commercial policies in directions favorable or at least acceptable to the U.S. Specific U.S. policy recommendations intended to accomplish this include:

- Adopt an overarching strategy of reciprocity in U.S.-Sino relations based on identifying objectives, incentives, leverage points, and desired end states for both nations.
- Institute a reciprocal policy of prohibiting Chinese investments in the same sectors from which U.S. companies are legally prohibited from investing in China. Publicly announce that the 2006 NDRC published catalog stipulating Chinese state monopolies in the domestic sectors of coal, oil, electricity, defense, telecommunications, air transport, and ocean shipping will form the basis of reciprocal restrictions applied to Chinese companies wanting to enter the U.S. market. Encourage partner nations to establish similar policies particularly in the European Union and in Japan.
- Publicly encourage Chinese investments in sectors of the U.S. economy as well as other countries where it clearly brings benefits to both the investor and the invested entity. Attempt to de-politicize ventures that appear to be purely commercial. For instance, a purchase of a U.S. white goods manufacturer by a Chinese white goods manufacturer should be encouraged.
- Discretely leverage unique U.S. access and influence across the spectrum of national power to insure secure supplies of energy resources at market prices. The U.S. today remains the world's premier power and the advantages associated with this special status should be brought to bear particularly in countries that depend on U.S. political and diplomatic support. Suppliers of key natural resources, including oil, should be persuaded to guarantee minimal supply levels at set prices that do not surpass a pre-established maximum.

- Highlight Chinese cooperation with and support for nefarious regimes in the world. Encourage a modification in Chinese behavior by underscoring the incompatibility of such policies with responsible global leadership. If China wants U.S. support for its increasing leadership role in international affairs (or least wants to avoid U.S. obstructionism), then China should adhere to established norms of behavior.
- Encourage greater Chinese involvement in existing international organizations by increasing its contributions to the budgets of the United Nations and the International Monetary Fund. China's greater role in international affairs should be accompanied by greater responsibility in paying on par with its new found voice globally.
- Welcome Chinese lending to debtor nations as long as it is in accordance with established international financial mechanisms and international financial aid norms. When this is not the case, debtor nations should be prevented from accepting Chinese loans via international financial organizations.
- End all U.S. aid programs to China and redirect those lines of funding to parts of the world in which U.S. influence may be under pressure. As the world's second largest economy, China should no longer be a U.S. aid recipient. Encourage partner nations, particularly in the European Union and in Japan, to establish similar policies.
- When positive reinforcement and encouragement for responsible Chinese behavior is unsuccessful, the U.S. should work with partner nations, international institutions, non-governmental organizations, and media groups to challenge and criticize questionable Chinese behavior.

Chapter 9 - A Concluding Analysis

The commonly used acronym DIME (diplomatic, informational, military, economic) refers to the various instruments of national power that can equate generally to comprehensive national power (CNP) construct described in Chapter 5. DIME provides a framework for analysis of a government's or a nation's means to reach its objectives. While certain components of DIME certainly lend themselves more towards implementing hard power, such as military forces, others are just as clearly instruments of soft power. Diplomatic efforts are generally regarded as emblematic of soft power although with some hard power implications.¹⁶² The information and economic aspects can be categorized as either hard or soft power depending on how they are employed. For example, information dominance can enhance military operations, but information can also be used to sway public opinion. Economic sanctions are clearly examples of hard power while economic success can attract admirers as a measure soft power.

The impressive growth of the biggest developing country in the world is a key economic and political issue. Consequently, China's growth in power, both hard and soft, due to its going global campaign can be evaluated in terms of DIME. As demonstrated in earlier chapters, its commercial achievements abroad connote significant success in other sectors, directly and indirectly. Chinese companies' access to resources, technologies, markets, and elites translates into means of influence and power than can be harnessed for a whole host of objectives that are not necessarily focused on commercial goals only. The Chinese economic position will naturally translate into much greater political power, affecting all other countries, as well as its international relations at the regional and global level. Using the DIME framework, this is a summary of examples, some of which may overlap, that underscore the link between China's economic strategy of going global with its geopolitical implications:

¹⁶²Yet, it must be remembered that some diplomatic actions such as demarches, the recalling of ambassadors, and the breaking of diplomatic relations can have real *hard* consequences. They may entail financial implications and political handicaps within the international community that constrain a government's freedom of diplomatic movement.

Diplomatic

- China has become increasingly assertive in its foreign policy given its position of economic strength and the relative decline of the West during the recent financial crisis.
- China petro-diplomacy has led it to protect odious regimes such as the governments in Khartoum and Tehran in the face of international condemnation.
- China has increasingly taken leadership positions in the UN, WTO, SCO, the Association of Southeast Asian Nations (ASEAN), and Asia-Pacific Economic Cooperation (APEC).

Informational

- China offers countries often snubbed by the West a blend of market economy and Leninism, economic diversity and strict one-party control as an attractive alternative to democracy.
- Chinese official and unofficial threats to sell-off U.S. treasuries could have a deterrent effect.
- China has ample ammunition for criticizing U.S. hypocrisy when Chinese companies are denied acquisitions of U.S. companies such as Maytag, Sprint, 3COM and Unocal.

Military

- China's economic success underwrites its ability to increase its military budget by 7.5% in 2010.
- Chinese commercial presence abroad has gradually taken a security perspective. Chinese workers have been kidnapped and killed in places such as Afghanistan, Angola, Cameroon, Ethiopia, Niger, Sudan, and Zambia. Chinese merchants have been targeted in the Solomon Islands. Growing nationalist voices in China have called on the government to send in the Chinese military to protect Chinese nationals abroad.
- Chinese overseas commercial activities can facilitate the acquisition of dual-use technologies.
- China's energy policies and leadership in SCO has direct military implications and may have led to Chinese pressure on Uzbek and Kyrgyz to expel U.S. military forces.

Economic

- China markets its model of economic growth with social stability (and without democratic values such as human rights) as an alternative to Western aid tied to Western values. Key examples include Burma and Venezuela.
- In Africa, Latin America, and the Middle East, China has strengthened its strategic economic relations by establishing cooperation forums and business councils in order to secure its access to primary goods and consolidate its export markets.
- China's massive consumption of global natural resources has caused a rise in world demand and prices of oil, natural gas, other hydrocarbons as well as a variety of commodities. This has presented a major opportunity for developing countries.

Objectively, there is no conclusive evidence that the rise of China is nothing more than the legitimate development and expansion of a growing and prospering country. In fact, the Chinese actually subscribe to the proposition that their "rise" is more akin to a renaissance as China was the world's largest economy for 18 of the last 20 centuries. Chinese observers are rightfully resentful of critics and cynics questioning China's justification for its "peaceful rise."

Yet, Western observers do raise their own legitimate concerns. Chinese mercantilist tendencies, increasingly assertive international behavior, and patronage of the most despicable regimes on the planet have caused alarm and trepidation. The recent and ongoing Libyan crisis has presented another example of China's growing interests globally in both commercial and military terms. Tens of thousands of Chinese workers, primarily from the petroleum and construction industries, had to be evacuated from Libya during the civil unrest. This large presence of Chinese workers came as a surprise to many international observers. The Chinese government conducted their own version of a non-combatant evacuation operation (NEO) using solely commercial assets. However, a Chinese warship, the Jiangkai-II Class missile frigate XUZHOU, was also present in the Mediterranean during this NEO. This was a first for China and did not go wholly unnoticed in the international press and in various foreign capitals. Chinese commercial activities abroad can carry military implications.

As Robert Kagan wrote, “Power changes nations. It expands their wants and desires, increase their sense of entitlement, their need for deference and respect. It also makes them more ambitious. It lessens their tolerance to obstacles, their willingness to take no for an answer.”¹⁶³ The question that the world is facing now is whether this century will be “the Chinese Century” and if the positive connotations thereof will outweigh the negative.

¹⁶³ “Less Biding and Hiding,” *The Economist*, December 4, 2010, 9.

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